Malaysian Institute Of Taxation

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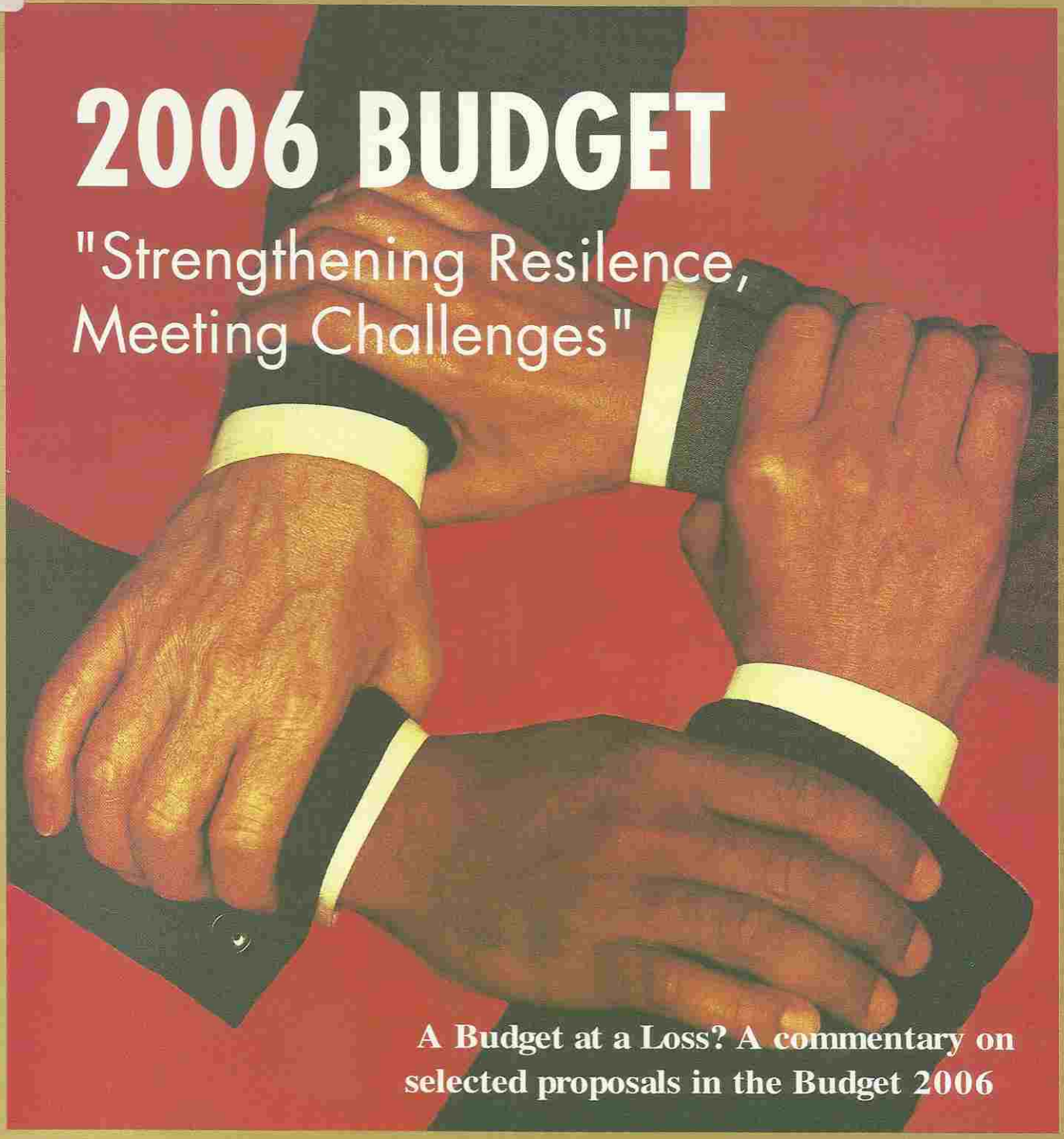

2006 BUDGET

"Strengthening Resilence, Meeting Challenges"

A Budget at a Loss? A commentary on selected proposals in the Budget 2006

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Al-Fatihah

The Council Members
together with the staff and members

of the

MALAYSIAN INSTITUTE OF TAXATION

Express their deepest sadness and offer heartfelt condolences

to

YAB Dato' Seri Abdullah bin Haji Ahmad Badawi
Prime Minister of Malaysia

On the demise of his loving wife

Datin Paduka Seri Endon Mahmood

Malaysian Institute Of Taxation

The President's Note

With the year 2005 coming to an end, it is time again for new resolutions and changes to welcome the new year. To this note, I am very happy to inform members that effective 19 December 2005 the Institute and the Secretariat will be operating out of the Institute's new office premises located at Megan Avenue II, Jalan Yap Kwan Seng, Kuala Lumpur. The new premises promise a bigger space equipped with its own training rooms as well as a library which will be set up very soon.

On a sombre note, the country mourned with our beloved Prime Minister on the demise of his loving wife, Datin Seri Endon Mahmood during the holy Ramadan month. We pray to the Almighty to give strength to YAB Dato' Seri Abdullah bin Ahmad Badawi during this difficult period.

In the months of October and November, the Institute organised some of its signature events. With the announcement of the 2006 Budget in September, the Institute arranged for an exclusive forum to update members on the major changes that were highlighted in the 2006 Budget. We had the privilege of having Datuk Aziyah bt Bahauddin the Under Secretary of Tax Analysis Division from Ministry of Finance to speak on the 2006 Budget proposals.

We successfully held a networking luncheon with Tan Sri Dato' Zainol Abidin bin Abd Rashid, the Chief Executive Officer of LHDNM right after the Deepavali and Hari Raya festivals. Members had the opportunities to network with senior officials from the various government agencies.

I attended the Asia Oceania Tax Consultants Association (AOTCA) General & Extraordinary Meeting in Manila, Philippines from 9 to 12 November 2005. I was accompanied by the Honorary Secretary, Mr Harpal Singh Dhillon at these meetings. The highlight at these meetings were the panel discussions on "Anti-Money Laundering practices and roles of tax/accounting professionals" and "Reform and Revolution: The Asia Pacific Economic and Fiscal Outlook". Apart from this, I am proud to announce that the Institute has been given the opportunity to host the next AOTCA General & Extraordinary Meetings as well as the 2nd AOTCA International Convention in 2007.

Best wishes for a happy new year!

Tuan Haji Abdul Hamid bin Mohd Hassan
President

The Editor's Note

Consequential to the announcement of 2006 Budget proposals presented by the Finance Minister, YAB Dato' Seri Abdullah bin Ahmad Badawi in September, MIT organized a host of seminars and a forum to update its members and the public on key issues and significant development in the taxation arena.

In conjunction with 2006 Budget announcement, in this issue Eow Siew Lee provides a summary of 2006 Budget and Nakha Raman Somasundaram presents a commentary on selected proposals in the Budget.

Other articles of interest include:

Offsetting: Effect on Tax Computations and Tax Instalments
In this article, Kenneth Yong demonstrates the frenzied labyrinth of tax rules and accounting standards specifically on the issue of offsetting which can create practical difficulties in tax computation and tax instalments.

What is GST to the Man in the Street
Chan Kee Hoong, the Tax Director of BDO discusses an array of issues in relation to the impending implementation of Goods and Services Tax (GST) in January 2007. His article covers questions and answers, simple examples, diagrams and tables that help readers to grasp the topic easily.

Time for Leave Passage to move on...
In this article, SG Toh put forward her views and reasons that employers should be allowed to tax deduction for Leave Passage benefits.

Myanmar: Tax Regulatory Framework
Lee Fook Hong provides an overview on Myanmar laws, investment regulatory framework, types of business vehicles for foreign investments and taxation.

E-Commerce: Tax Problems and Challenges
Hajah Mustafa Mohd Hanefah, Zaleha Othman and Haslinda Hassan of the Faculty of Accountancy, Universiti Utara Malaysia highlight the problems and challenges E-Commerce will bring to the tax authorities. This article also discusses steps that have been taken to examine the impact of E-Commerce on the tax system in many countries.

Learning Curve: Trading with and Trading within Malaysia
Siva Nair discusses the issue of taxable income in the context of business presence and the definition of trading with and trading within Malaysia. The article also discusses the various factors, including the existence and effect of a Double Taxation (Relief) Agreement, in relation to the business activities being carried out.

Customs Inspection of Containers
Thomas Selva Doss explains the customs requirements, importation procedures, declaration of goods and preventive investigation for wrongful declaration in relation to international shipments in the form of containers.

Harpal S. Dhillon
Editor of Tax Nasional

Tax Nasional

Official Journal of the Malaysian Institute of Taxation

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Contents

4th Quarter 2005

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.

Goods & Services Tax

Council Member, Dr Veerinderjeet Singh presenting the souvenir to Mr Kang Beng Hoe from PricewaterhouseCoopers.


Presentation by Mr Robin Chia

Goods & Services Tax (GST) will be implemented in January 2007. GST is replacing the present sales tax and service tax to enhance and improve competitiveness, efficiency and transparency in the Malaysian economy. The Institute assembled a pool of local and international experts in the area of indirect tax to discuss and exchange views on pertinent issues that may arise with the implementation of GST at a seminar on GST on 14 September 2005 at the Legend Hotel, Kuala Lumpur.

Approximately 200 participants attended the seminar where a range of issues pertaining to GST ie. the implementation and the treatment for various industries were presented by the relevant speakers.

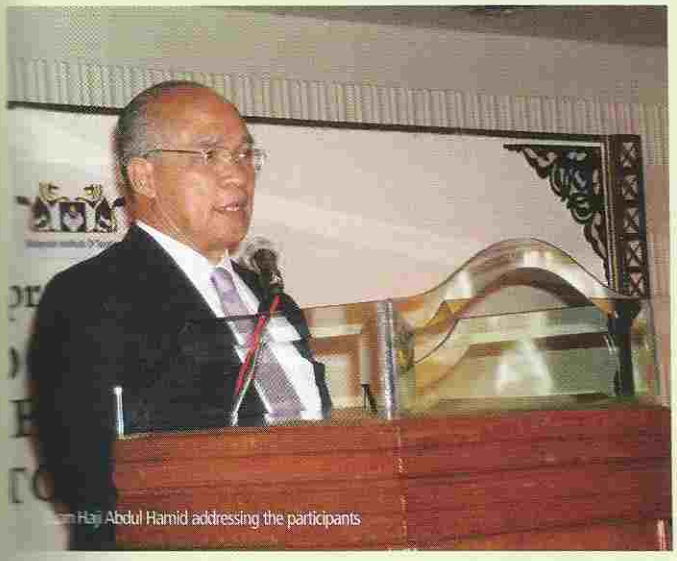
2006 Budget Breakfast Forum

Key speaker: Y Bhg Datuk Aziyah bt Bahauddin

With the announcement of the 2006 Budget proposals by the Finance Minister, YAB Dato' Seri Abdullah bin Ahmad Badawi in September, the Institute organised an exclusive Breakfast Forum on the Budget proposals to update its members as well as the public on the new proposals and measures. The Institute had the privilege of having Y Bhg Datuk Aziyah bt Bahauddin, the Under Secretary of the Tax Analysis Division from the Ministry of Finance as the key speaker at this exclusive forum. Datuk Aziyah presented a comprehensive analysis of the key tax issues contained in the 2006 Budget proposals. Participants had the benefit of listening to the discussion and different views of the panelists from the Royal Customs Malaysia, Lembaga Hasil Dalam Negeri Malaysia and the profession in the open forum session.

During the Q&A session, participants raised various issues and sought clarification from the key speaker as well as the panelists present on the day.

Participants listening to points raised by the speaker



Haji Abdul Hamid addressing the participants

Participants at the breakfast forum

Corporate Luncheon

Deputy President, Mr Thanneermalai in a discussion with the Under Secretary of Tax Analysis Division, Ministry of Finance, Y Bhg Datuk Aziyah bt Bahauddin

Some of the members and guests present at the networking luncheon

A member chatting with Council Member, Mr Adrian Yeo

A special networking luncheon was arranged for the Institute's members at KL Hilton recently. The Chief Executive Officer of Lembaga Hasil Dalam Negeri Malaysia (LHDNM), Tan Sri Dato' Zainol Abidin bin Abd Rashid was the Guest of Honour at this luncheon.

Several key personnel and senior level officials from government agencies attended this networking luncheon. This is the Institute's signature event, the focus of which is to provide an opportunity to our members to get to know the CEO of LHDNM as well as to network with senior level officials from the government agencies.

23RD NATIONAL SEMINAR ON TAXATION

The Inland Revenue Officers' Union (IROU) conducted the 23rd National Seminar on Taxation. Jointly organised by MIA and MIT, this one day seminar discussed the budget proposals and field audit issues, i.e. the duties, responsibilities and rights of the taxpayer in field audit.

MIT - MIA 2006 Budget Proposals and Recent Developments

The Institute, in collaboration with MIA organized a half day seminar on the 2006 Budget Proposals to update and share with the members the key issues of the Budget Proposals in the Finance Bill and other significant recent tax developments in Malaysia.

The speaker, Mr Harpal Singh presented an informative analysis of the tax changes on the 2006 Budget. This seminar was supported by the Malaysian Institute of Chartered Secretaries and Administrators.

Nationwide Roadshow on 2006 Budget Proposals

The Institute teamed up again with MIA to organize the half day seminar on 2006 Budget Proposals and Recent Developments at several major states in the country. For outstation members, this was indeed an opportunity for them to listen to the views of the tax experts on the 2006 Budget Proposals as well as some of the recent tax developments taking place in the profession.

TRANSFER PRICING - CHALLENGES AHEAD

Two years have passed since the Transfer Pricing Guidelines were issued by the Lembaga Hasil Dalam Negeri Malaysia, but there are still issues surrounding the guidelines that require further clarification and explanation.

These issues were discussed and presented by local transfer pricing specialist in a seminar arranged by the Institute recently. Speakers from big four accounting firms spoke on various areas in transfer pricing from the latest developments in transfer pricing audits to the key challenges in applying the pricing methods in practice.

Refresher Tip

Provision of testing services for the purpose of obtaining test results on finished products to meet required standards do not fall within the scope of sec. 4A of the *Income Tax Act 1967*.

(based on Public Ruling 4/2005 Withholding Tax on Special Classes of Income issued on 12 September 2005)

Malaysian Institute Of Taxation

CONTINUING PROFESSIONAL DEVELOPMENT (CPD)

TRAINING PROGRAMMES/EVENTS - 1st Quarter 2006

Date	Training Programme	Time	Venue	Speaker
January 2006				
5	Evening Talk: RPGT - The Latest Development	6:30 pm - 8:30 pm	Kuala Lumpur	Robin Noronha
7	Workshop: MIT Tax Courses Part A - Module 1	9 am - 5 pm	Kuala Lumpur	Robin Noronha
12	Tax Seminar: Planning Ahead	9 am - 5 pm	Kuala Lumpur	Various speakers
17	Workshop: Taxation for Individuals - Module 2	9 am - 5 pm	Kuala Lumpur	Wong Yok Chin
19	Workshop: Maximisation of Incentives for Manufacturing Companies	9 am - 5 pm	Penang	Chow Chee Yen
20	Workshop: Maximisation of Incentives for Manufacturing Companies	9 am - 5 pm	Johor Bahru	Chow Chee Yen
21	Workshop: MIT Course Part A - Module 3	9 am - 5 pm	Kuala Lumpur	Robin Noronha
25	Workshop: MIT Course Part B - Module 1	9 am - 5 pm	Kuala Lumpur	Harvindar Singh
February 2006				
8	Workshop: MIT Tax Course Part B - Module 2	9 am - 5 pm	Kuala Lumpur	Harvindar Singh
11	Workshop: MIT Tax Course Part A - Module 4	9 am - 5 pm	Kuala Lumpur	Robin Noronha
15	Workshop: Taxation for Sole Proprietor and Partnership - Module 5	9 am - 5 pm	Kuala Lumpur	Wong Yok Chin
18	Workshop: MIT Tax Course Part B - Module 3	9 am - 5 pm	Kuala Lumpur	Harvindar Singh
25	Workshop: MIT Tax Course Part A - Module 6	9 am - 5 pm	Kuala Lumpur	Harvindar Singh
28	Seminar: Real Estate Investment Trusts	9 am - 5 pm	Kuala Lumpur	Various Speakers
March 2006				
2	Workshop: MIT Tax Course Part B - Module 4	9 am - 5 pm	Kuala Lumpur	Harvindar Singh
4	Workshop: Practical Application in Preparing for a Tax Audits	9 am - 5 pm	Johor Bahru	Soh Lian Seng
11	Workshop: MIT Tax Course Part A - Module 7	9 am - 5 pm	Kuala Lumpur	Robin Noronha
18	Workshop: Practical Application in Preparing for a Tax Audits	9 am - 5 pm	Penang	Soh Lian Seng
25	Workshop: MIT Tax Course Part A - Module 8	9 am - 5 pm	Kuala Lumpur	Harvindar Singh

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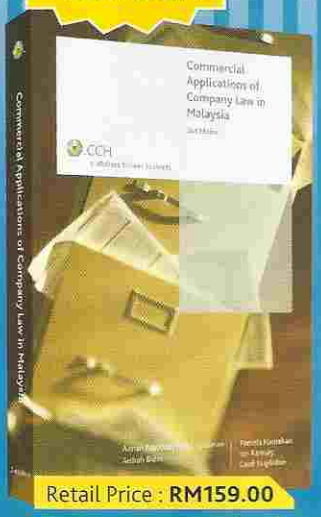

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13 Consequences of breach of duty
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Technical Updates

(4th Quarter - as at 15 November 2005)

BY MIT TECHNICAL DEPARTMENT

Public Ruling

The ***Public Ruling 3/2005 on Living Accomodation Benefit Provided for the Employee by the Employer*** was issued by the Inland Revenue Board (IRB) on 11 August 2005. This Ruling explains the tax treatment of living accommodation provided for an employee by his employer and the method used to calculate the value of that benefit.

Legislation

Gazette Orders

The following Orders and Rules have been gazetted. The key features are highlighted below.

- ***Income Tax (Exemption) (No.40) Order 2005 [P.U.(A) 307]***
  - with effect from year of assessment 2003, an operational headquarters company (OHQ) is exempted from the payment of income tax on its statutory income from its business for a period of ten years of assessment commencing from a year of assessment in which the date of approval of such incentive was given.
  - an OHQ is defined as a company carrying on a business in Malaysia providing qualifying services and approved by the Minister upon fulfilling specified conditions.
  - the statutory income exempted shall be on-

(a) all income from the provision of qualifying services; and

(b) a part of the income from the provision of services in Malaysia determined in accordance with the following formula:-

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

where,

A is the amount as determined in accordance with the following formula:-

$$\frac{20}{80} \times \text{amount of all income from the provision of qualifying service;}$$

B is the amount of gross income from services in Malaysia;

C is the amount of statutory income from services in Malaysia.

  - this exemption shall not apply where the OHQ has been granted any incentives (except deductions for promotion of exports) under the *Promotion of Investments Act 1986* or any exemption or allowances or deduction given under the *Income Tax Act 1967* in respect of its non-qualifying income.

- *Income Tax (Exemption) (No.41) Order 2005 [P.U.(A) 308]*
  - with effect from year of assessment 2003, a regional distribution centre company (RDC) is exempted from the payment of income tax on its statutory income from its business for a period of ten years of assessment.
  - the RDC is defined as a company or a division of a company incorporated in Malaysia which carries on a business of providing qualifying activities and which is approved by the Minister upon fulfilling specified conditions.
  - the statutory income exempted shall be on-

(a) all income from the qualifying activities in respect of its direct export sales;

(b) a part of the income from the qualifying activities in relation to its drop shipment export sales to be determined in accordance with the following formula:-

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

where,
A is the amount as determined in accordance with the following formula:-

$$\frac{30}{50} \times \text{value of direct export sales;}$$

or the value of drop shipment export sales, whichever is the lower

B is the annual value of the sales from the qualifying activities;

C is the amount of statutory income from the qualifying activities; and

(c) a part of the income from the qualifying activities in relation to its local sales to be determined in accordance with the following formula:-

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

where,
D is the amount as determined in accordance with the following formula:-

$$\frac{20}{80} \times E;$$

where,
E is the total value of direct export sales and value of A, or the value of local sales, whichever is the lower;

B is the annual value of sales from the qualifying activities;

C is the amount of statutory income from the qualifying activities.

  - this exemption shall not apply where the RDC has been granted any incentives (except deductions for promotion of exports) under the *Promotion of Investments Act 1986* or any exemption or allowances or deduction given under the *Income Tax Act 1967* in respect of its non-qualifying income.

- *Income Tax (Exemption) (No.42) Order 2005 [P.U.(A) 309]*
  - with effect from year of assessment 2003, an international procurement centre (IPC) company is exempted from the payment of income tax on its statutory income from its business period for a period of ten years of assessment.
  - an IPC is defined as a company or a division of a company incorporated in Malaysia which carries on a business of providing qualifying activities and which is approved by the Minister upon fulfilling specified conditions.
  - the statutory income exempted shall be on-

(a) all income from the qualifying activities in respect of its direct export sales;

(b) a part of the income from the qualifying activities in relation to its drop shipment export sales to be determined in accordance with the following formula:-

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

where,
A is the amount as determined in accordance with the following formula:-

$$\frac{30}{50} \times \text{value of direct export sales;}$$

or the value of drop shipment export sales, whichever is the lower;

B is the annual value of the sales from the qualifying activities;

C is the amount of statutory income from the qualifying activities; and

(c) a part of the income from the qualifying activities in relation to its local sales to be determined in accordance with the following formula:-

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

where,
D is the amount as determined in accordance with the following formula:-

$$\frac{20}{80} \times E;$$

where,
E is the total value of direct export sales and value of A, or the value of local sales, whichever is the lower:

B is the annual value of sales from the qualifying activities;

C is the amount of statutory income from the qualifying activities.

- this exemption shall not apply where the IPC has been granted any incentives (except deductions for promotion of exports) under the *Promotion of Investments Act 1986* or any exemption or allowances or deduction given under the *Income Tax Act 1967* in respect of its non-qualifying income.

- ***Stamp Duty (Exemption) (No.3) (Amendment) Order 2005 [P.U. (A) 313]***
  - this Order seek to amend the *Stamp Duty (Exemption) (No.23) Order 2000 (P.U. (A) 241/2000)* with effect from 3 July 2004.
  - the word "debenture" shall have the meaning assigned by subsec. 2(1) of the *Securities Commission Act 1993*.
  - the word "Islamic Securities" shall have the meaning prescribed in the *Securities Commission (Prescription of Islamic Securities) Order 2004 (P.U. (A) 230/2004)*.

- ***Stamp Duty (Exemption) (No.4) (Amendment) Order 2005 [P.U. (A) 314]***
  - this Order seek to amend the *Stamp Duty (Exemption) (No.12) Order 2001* (P.U. (A) 226/2001) with effect from 3 July 2004.
  - the definition of "assets" will not include the word "debt".
  - the definition of "special purpose vehicle" will not include the word "debt" wherever it appears.

- ***Income Tax (Deduction for Expenditure on Issuance of Islamic Securities) Rules 2005 [P.U.(A) 320]***
  - these Rules seek to revoke the *Income Tax (Deduction for Expenditure on Issuance of Private Debt Securities Under Islamic Principles) Rules 2003 (P.U. (A) 107/2003)* with effect from 3 July 2004.
  - in ascertaining the adjusted income for the basis period for a year of assessment, a deduction of an amount equal to the expenditure incurred on the issuance of Islamic Securities from 3 July 2004 until the year of assessment 2007 shall be allowed.
  - "Islamic Securities" means Islamic securities which adopt the principles of *mudharabah*, *musyarakah* and *ijarah*.

- ***Income Tax (Deduction for Expenditure on Issuance of Asset Backed Securities) Rules 2005 [P.U.(A) 321]***
  - these Rules seek to revoke the *Income Tax (Deduction for Expenditure on Issuance of Asset Backed Debt Securities) Rules 2003 (P.U. (A) 473/2003)* with effect from 3 July 2004.
  - in ascertaining the adjusted income for the basis period for a year of assessment, a deduction of an amount equal to the expenditure incurred on the issuance of asset backed securities from 3 July 2004 until the year of assessment 2007 shall be allowed.
  - "asset backed securities" means private debt securities or Islamic securities that are issued pursuant to a securitisation transaction.
  - "securitisation transaction" means an arrangement approved by the Securities Commission pursuant to sec. 32 of the *Securities Commission Act 1993* which involves the transfer of assets or risks to a third party where such transfer is funded by the issuance of debt securities to investors.
  - these Rules shall not apply to any expenditure allowable under paragraph 33(1) (a), 33(1) (b) or 33(1) (c) of the *Income Tax Act 1967* and the *Income Tax (Deduction for Expenditure on Issuance of Islamic Securities) Rules 2005 (P.U. (A) 320/2005)*.

- ***Income Tax (Deduction for Expenditure on Issuance of Islamic Securities Pursuant to Istisna' Principle) Rules 2005 [P.U.(A) 322]***
  - these Rules seek to revoke the *Income Tax (Deduction for Expenditure on Issuance of Islamic Private Debt Securities Pursuant to Istisna' Principle) Rules 2003 (P.U. (A) 474/2003)* with effect from 3 July 2004.
  - in ascertaining the adjusted income for the basis period for a year of assessment, a deduction of an amount equal to the expenditure incurred on the issuance of Islamic securities pursuant to *istisna'* principle from 3 July 2004 until the year of assessment 2007 shall be allowed.

- ***Promotion of Investments (Promoted Activities and Promoted Products for Small Scale Companies) (Amendment) (No.2) Order 2005 [P.U.(A) 366]***
  - this Order seek to include the following items as promoted products.

Industry	Products/Activities	Effective Date
Assembly and manufacture of electrical & electronic products and components & parts thereof	Testing Equipment	3 February 2005
	Energy Saving Lighting and/or Display	3 February 2005
Manufacturing of plastic products	Geosystem Products (cellular confinement systems)	13 January 2005

- ***Promotion of Investments (Promoted Activities and Promoted Products for High Technology Companies) (Amendment) (No.2) Order 2005 [P.U.(A) 367]***
  - this Order seek to include the following items as promoted products.

Industry	Product	Effective Date
Advance Electronics	Design, development and manufacture of Electro Magnetic Interference (EMI) shielding products.	11 March 2005
	Design, development and manufacturer of contra rotator washing machines	13 October 2004
Equipment/Instrumentation	Design, development and manufacture of air flow equipments and related products.	11 March 2005

- *Promotion of Investments (Promoted Activities and Promoted Products) (Amendment) (No.2) Order 2005 [P.U.(A) 368]*
  - this Orders seek to include the following items as promoted products.

Industry	Product	Effective Date
Manufacture of oil palm products and their deriviatives	Crude palm kernel oil and palm kernel cake/expeller	25 November 2004
	Palm-based nutraceuticals, constituents of palm oil/palm kernel oil	25 November 2004
Manufacture of oil palm products and their deriviatives	Palm-based food products	11 December 2004
	Processed products from - palm fatty acid distillate/palm kernel fatty acid distillate - palm kernel cake/expeller - palm oil mill effluent	25 November 2004
	Products from palm biomass	8 January 2004
Manufacture of clay based, sand-based and other non-metallic mineral products	Crystallised glass panels	14 October 2004
Miscellaneous	Personal ballistic armour	29 July 2004

  - a new industry has also been added.

Industry	Products/Activities	Effective Date
Manufacturer of kenaf based food product	Animal feed, kenaf particle or fibre, reconstituted panel, board or products and mouled producs.	9 December 2004

  - item V "Manufacture of palm and palm kernel oil products and their deriviatives" has been replaced with "Manufacture of oil palm products and their deriviatives".

- *Income Tax (Deduction for Cash Contribution and Sponsor of a Cultural or Arts Show Held in Federal Territory Kuala Lumpur) Rules 2005 [P.U.(A) 380]*
  - these Rules take effect from the year of assessment 2005.
  - in ascertaining the adjusted income for the basis period for a year of assessment, a deduction equivalent to the amount of cash contribution and sponsorship in the form of cash incurred in respect of a cultural or arts show which is held in Federal Territory Kuala Lumpur shall be allowed.
  - "cultural or arts show" is defined as a stage performance approved by the Ministry of Culture, Arts and Heritage and organised with the participation of foreign nationals who have made at least three performances in foreign countries other than their own.
  - these Rules shall not apply to a company which has made a claim either in full or partial for deduction under sec. 34(6)(k) of the *Income Tax Act 1967*.

- *Double Taxation Relief (The Government of the Republic of South Africa) Order 2005 [P.U.(A) 385]*

Some salient points of the double tax treaty:-

Withholding Tax Rates

- interest	–	10% (Article 11)
- royalties	–	5% (Article 12)
- technical fees	–	5% (Article 13)

Definition of Permanent Establishment (Article 5) Includes:-

- a building site, a construction, installation or assembly project or any supervisory activity in connection with such site or project, which lasts for more than 12 months;
- the furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, for a period or periods exceeding 183 days in any 12 months period.

Offshore Business Activities

- The benefits of this treaty will not be available to any offshore business activities carried out under the *Labuan Offshore Business Activity Tax Act 1990*.

- *Income Tax (Deduction for Unemployed Graduates Allowances) Rules 2005 [P.U.(A) 387]*
  - these Rules take effect from 1 February 2004.
  - banking institution, insurance company or takaful business operator will be allowed a double deduction of the amount of allowances paid to a trainee for undergoing training programme for the period from 1 February 2004 until 31 January 2007.
  - to qualify, they would need to produce a letter from the training institution certifying that the trainee has undergone such training and the amount of allowances incurred.

2006 Budget Proposals

The Prime Minister presented the budget proposals for the year 2006 to the Parliament on 30 September 2005. A copy of the 2006 Budget Speech is available on our website at www.mit.org.my.

Miscellaneous

Human Resources Development Levy

The accounting and auditing industry (i.e. the practice of public accounting or auditing or taxation or furnishing of reports or other documents filed with the relevant authorities or otherwise prepared under the securities law) has now been removed from Part I, First Schedule of the Pembangunan Sumber Manusia Berhad (PSMB) Act 2001. This amendment is effective from 1 January 2005.

Members who wish to enquire further may contact PMSB directly at 03-2098 4800.

A SUMMARY OF THE 2006 BUDGET

BY EOW SIEW LEE

The 2006 Budget was aptly themed "Strengthening Resilience, Meeting Challenges" at a time where Malaysia is trying to balance its budget deficit against rising oil prices, higher interest rates and increasing global competition. The Government has successfully reduced the deficit of 5.6% of GDP in 2002 to an estimated 3.8% for this year.

For this Budget, a sum of RM136.8 billion is proposed of which a total of RM101.3 billion is for Operating Expenditure and RM35.5 billion for Development Expenditure.

Four budget strategies were announced:-

- Implementing proactive Government measures to accelerate economic growth
- Providing a business-friendly environment
- Developing human capital
- Enhancing the well-being and quality of life of Malaysians.

Some of the proactive measures proposed included accelerating rural development, optimizing the utilization of existing infrastructure (and to inculcate a maintenance culture) as well as improving the Government's delivery system and procurement system.

Several tax and non-tax measures have been implemented to reduce the cost of doing business to enable businesses to remain competitive. One such tax measure includes the introduction of the long awaited group relief incentive. This relief will allow companies within a group to utilize 50% of the current year loss of a surrendering company against the profits of the claimant company, subject to satisfying the required conditions, for eg. a minimum 70% ownership test and a paid up capital exceeding RM2.5 million for both the surrendering and claimant companies. This proposal signifies the Government's recognition of the importance of the private sector to stimulate economic growth albeit it comes with some restrictions.

Along with the group relief, an anti-avoidance measure has also been introduced. Accumulated losses and unabsorbed capital allowances of a company can no longer be carried forward in the event there is a change of more than 50% in its shareholdings. It is interesting to note that other countries impose the continuity of ownership test as well.

The proposal to allow the carry forward of unabsorbed business losses and capital allowances by a pioneer company reinstates

the attractiveness of the incentive, particularly to a loss-making pioneer company which would have been better off without the incentive.

Another round of mergers and acquisitions (M&As) will be expected of companies listed on Bursa Malaysia with the proposal to exempt stamp duty and real property gains tax on M&As that are approved by the Securities Commission from 1 October 2005 to 31 December 2007 and completed not later than 31 December 2008.

Various incentives have also been proposed to promote the growth of new sectors with high growth potential and competitive edge such as biotechnology, nanotechnology and high-technology manufacturing.

To further encourage ICT and multimedia activities, 50% pioneer status or investment tax allowance has been proposed for multimedia companies operating outside of Cybercities.

The efforts to improve the infrastructure facilities or have state-of-the-art facilities will not be optimized without the development of human capital. Adequate education and training is necessary to equip Malaysians with the relevant knowledge, skills and positive values to meet the increasing challenges.

Two such proposals are (1) the automatic relief of RM4,000 to be given for each child pursuing tertiary education at a recognized local institution of higher learning at diploma level and above or at a recognized overseas institution at degree level and above and (2) a RM4,000 relief for each disabled child pursuing tertiary education at a recognized local institution of higher learning at diploma level and above or at a recognized overseas institution at degree level and above (in addition to the existing disabled child relief of RM5,000).

Another twist to the Budget is the amendment to sec. 153(3) of the *Income Tax Act 1967*. It has been proposed that effective from 1 January 2006, a professional accountant authorised by or under any written law to be an auditor of companies can no longer be a tax agent. However, auditors who have been licensed before 1 January 2006 shall continue to act as tax agents. Going forward, a person who wishes to perform tasks relating to taxation would be required to obtain a tax agent license. This move is seen as an effort to enhance the competency of tax agents to ensure taxpayers are serviced by qualified agents.

Some other budget proposals are summarized below:-

- Extending the application period of incentives for the promoted areas to December 2010.
- Special treatment for listed investment holding companies.
- Specifying that audit fees are a deductible expense.
- Allowing a deduction for small value assets up to RM10,000 (instead of capital allowances).
- Relaxing the rule for estimation of income tax liability.
- Allowing a deduction for consultancy, legal and valuation service fees incurred in the establishment of a real estate investment trust.
- Extending the relief for further education to professional qualifications and to accounting and law courses in institutions of higher learning.
- Streamlining the treatment of discounts and premiums on bonds for financial and non-financial institutions.
- Specifying the basis of apportionment of interest expense between leasing and non-leasing activities.
- Granting a deduction for specific expenses incurred in the development of new courses by private institutions of higher learning.
- Granting a double deduction for allowances given by listed companies under a training programme for unemployed graduates.
- Allowing capital allowances over three years on moulds acquired to manufacture Industrial Building System (IBS) components.
- Exemption on certain royalty income from artistic works and exemption of withholding tax on payments to non-residents in the performing arts field, etc.
- Review of incentives for generation of renewable energy and conservation of energy.

Many were disappointed with no announcement of any reduction in the corporate and personal tax rates in light of the implementation of Goods and Services Tax in 2007. Nonetheless, we are still hopeful that come 2007 there would be a surprise for all. Until then, let us make full use of what we have before us to spur the economy.

The Author

Eow Siew Lee was previously attached to the tax practice of one of the Big 4 firms. She is currently with the Malaysian Institute of Taxation as their Technical Manager. The views expressed are the personal views of the author.

How to become a member of the Malaysian Institute of Taxation

Malaysian Institute Of Taxat
http://www.mit.org.m

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 Chartere Accountant without Practising Certificate and has had n less than three (3) years practical experience in practice o employment relating to taxation matters approved by th Council.

7. Any person who is registered with MIA as a License Accountant and who has had not less than five (5) yea practical experience in practice relating to taxation matte approved by the Council after admission as a license accountant of the MIA under the Accountants Act, 1967.

8. Any person who is an approved Tax Agent under Section 15 of the Income Tax Act, 1967.

Fellow Membership

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

APPLICATION FOR MEMBERSHIP

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

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

	Fellow
(a) Upgrading Fee	*RM300*
(b) Annual Subscription	*RM200*
	Associate
(a) Admission Fee	*RM200*
(b) Annual Subscription	*RM150*

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

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

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

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

Professional Examinations

Be Among The Best

The principal objective of the Malaysian Institute of Taxation (MIT) is to train and build up a pool of qualified tax personnel as well as to foster and maintain the highest standard of professional ethics and competency among its members.

One avenue of producing qualified tax personnel is through professional examinations. As such, MIT conducted its first professional examinations in December 1995. To date, the MIT has successfully conducted ten examinations. The professional examination also seeks to overcome the present shortage of qualified tax practitioners in the country.

How to Register

You can contact the Institute's Secretariat for a copy of the Student's Guide. The Guide contains general information on the examinations. Interested applicants must submit a set of registration forms as well as the necessary documents to the Secretariat.

Entrance Requirements

a) Minimum 17 years old
- At least 17 years old
- At least two principal level passes of the HSC/STPM examination (excluding Kertas Am/Pengajian Am) or equivalent
- Credits in English Language and Mathematics and an ordinary pass in Bahasa Malaysia at MCE/SPM

b) Degrees, diplomas and professional qualifications (local/overseas) recognised by the MIT to supersede minimum requirements in (a)

c) Full Members of local and overseas accounting bodies

Exemption

Exemption from specific papers in the professional examinations is available and the exemptions granted will depend on qualifications attained and course contents as determined by the MIT Council.

Malaysian Institute Of Taxation

Exemption Fees (per paper)

Foundation	RM 50.00
Intermediate	RM 60.00
Final	RM 70.00

Examination Fees (per paper)

Foundation	RM 50.00
Intermediate	RM 60.00
Final	RM 70.00

Examination Structure

The professional examinations are currently held annually and comprises of three levels:

Foundation Level
- Taxation I
- Economics & Business Statistics
- Financial Accounting 1

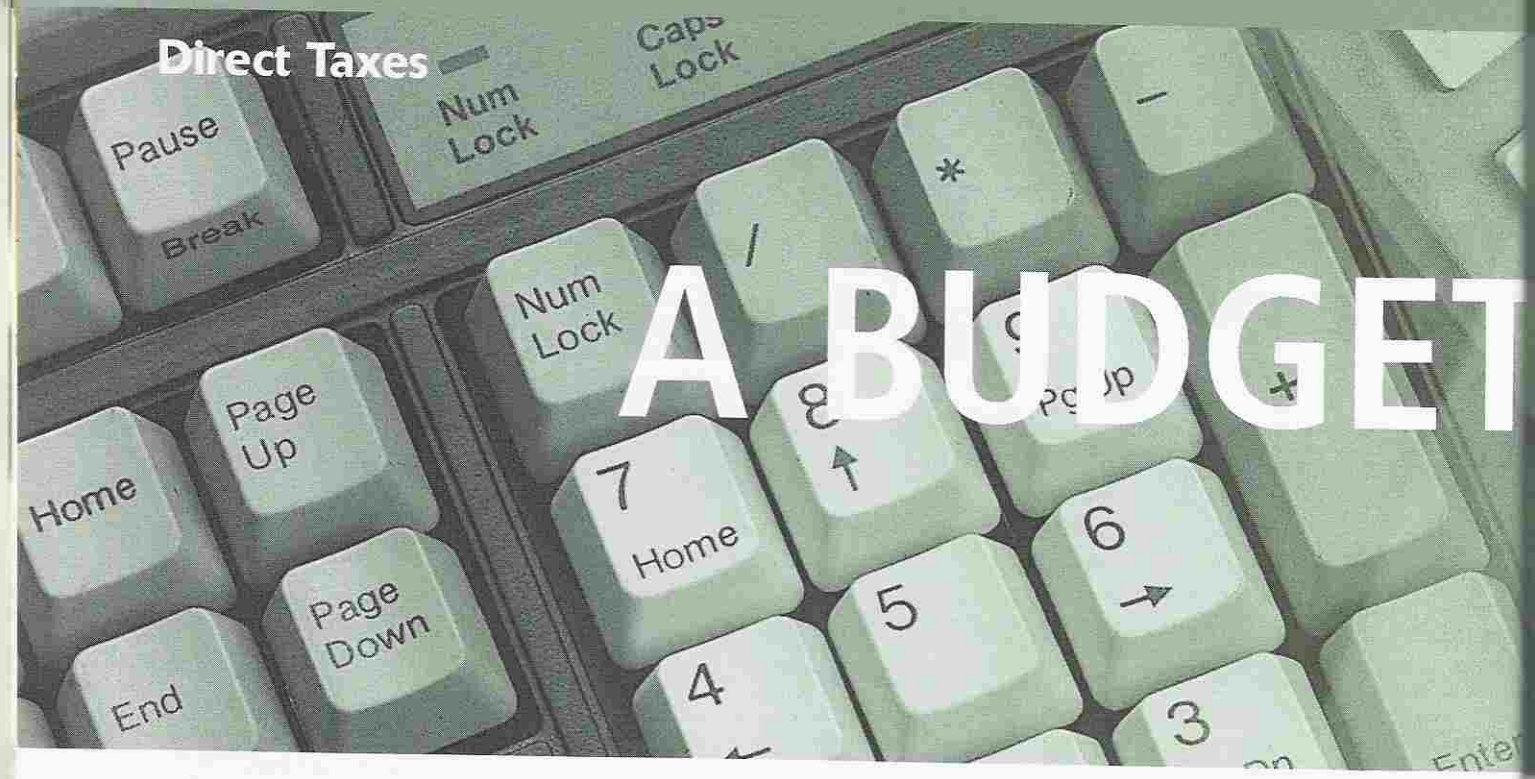
Intermediate Level
- Taxation II
- Taxation III
- Company & Business Law

Final Level
- Taxation IV
- Taxation V
- Business & Financial Management
- Financial Accounting II

MIT Professional Examinations

CALENDAR FOR YEAR 2005

January 1	Annual Subscription for 2005 payable.
February	Release of the 2004 Examinations results. Students are notified by post. No telephone enquiries will be entertained.
March 31	Last date for payment of annual subscription fee for the year 2005 without penalty (RM50).
April 30	Last date for payment of annual subscription for year 2005 with penalty (RM100). Question & Answer Booklets are available for sale.
September 1	Closing date for registration of new students who wish to sit for the December 2005 examination sitting.
September 15	Examination Entry Forms will be posted to all registered students.
October 15	Closing date for submission of Examinations Entry Forms. Students have to return the Examinations Entry Form together with the relevant payments to the Examinations Department.
November 30	Despatch of Examinations Notification Letter.
December 19 - 23	MIT Examinations.



A BUDGET

ABSTRACT

The 2006 Budget was not one that was expected to blow Malaysians away as did Katrina in Louisiana and Wilma in Mexico. It was, in fact, a low-key budget adopting a pro-business and pro-growth approach to be implemented against the background of escalating oil prices influencing economies worldwide.[1]

This article will take an in-depth look at some of the landmark changes that was wrought to the Malaysian tax landscape by the recent Budget proposals.

GROUP RELIEF

This is considered by tax pundits to be a major move against the background of globalization.

The proposal is not something new - taxpayers in the approved food production, forest plantation, biotechnology, nanotechnology as well as optics and photonics were already enjoying group relief on losses incurred by their subsidiaries which undertook those projects. These companies were allowed to set off 100% of their losses incurred by their subsidiaries. Apart from those industries or businesses mentioned above the others are not able to avail themselves of this relief.

The 2006 Budget now extends this group relief to all locally incorporated resident companies.[2] The relief is however limited to 50% of the current year's adjusted loss,[3] which can be set off against the defined aggregate income[4] of another company within the same group. Nevertheless, some stiff conditions must be fulfilled before a company can avail itself to this group relief:

- The surrendering company and the claimant company are related companies throughout the basis period for that year of assessment and the twelve months period immediately preceding that basis period;
- The surrendering company and the claimant company must have paid up capital of ordinary shares exceeding RM2.5 million at the beginning of the basis period for that year of assessment;
- Both the surrendering company and the claimant company must have a twelve-month basis period ending on the same day;
- The claimant company has a defined aggregate income for that year of assessment;
- The surrendering and the claimant company are subject to tax at the appropriate rates.[5]

The companies are considered related if:[6]

- 70% of the shareholding of the surrendering company is directly or indirectly owned by the claimant company;
- 70% of the shareholding of the claimant company is directly or indirectly owned by the surrendering company;
- The 70% of the paid up capital of the surrendering company and the claimant company are directly or indirectly owned by another company; and
- The company (surrendering company or claimant company as the case maybe) is beneficially entitled to at least 70% of any residual profits of the other company available for distribution to the other company's equity holders; and 70% of the residual assets of the other company is available for distribution to the other company's equity holders in the event of a winding-up.

1 For example in Indonesia, by conservative estimates, at least one million workers are expected to lose their jobs by the end of 2005 on account of the higher oil prices and the dismantling of the fuel subsidy in that country (*STAR*, Saturday, 22 Oct 2005 p. 39).
2 A company is resident in Malaysia if its management and control is exercised in Malaysia.
3 Sec. 44A(1) of the *Income Tax Act 1967*.
4 'Defined aggregate income' is defined in sec. 44A(12) as the aggregate income of a claimant company for that year reduced by a deduction made pursuant to sec. 44(1)(a), (b), (c) and (d) of *the Income Tax Act 1967* (as amended).
5 Para 2 of Part I, Schedule 1.
6 Sec. 44A(3) of the *Income Tax Act 1967*.

TAT A LOSS?

A commentary on selected proposals in the 2006 Budget

BY NAKHA RATNAM SOMASUNDARAM

The relief is not available if a company:[7]

- Is a pioneer company or has been granted approval for investment tax allowance under the *Promotion of Investments Act 1986*;
- Is exempt from tax on its income under sec. 54A, sec. 127(3)(b) or 127(3A);
- Has made a claim for a reinvestment allowance under Schedule 7A of the *Income Tax Act 1967 (as amended)*;
- Has made a claim for deduction in respect of an approved food production project under the *Income Tax (Deduction for Investment in an Approved Food Production Project) Rules of 2001*;
- Has made a claim for deduction under the *Income Tax (Deduction of the Cost of Proprietary Rights) Rules 2002*;
- Has been granted a deduction under the *Income Tax (Deduction for Cost of Acquisition of a Foreign Owned Company) Rules 2003*; or
- Has made a claim for any deduction under any rules made under sec. 154 and those rules provide that this section does not apply to that company

How does this work out in practice?

Three different situations can arise in the surrendering and claiming of the losses:

- A single surrendering company surrendering its losses to a single claimant company
- A single surrendering company surrendering its losses to more than one claimant company
- More than one surrendering company surrendering their losses to a single claimant company

In the following illustrations, the possible application of the group relief is examined:

Illustration 1

Company A, incorporated and resident in Malaysia has a paid-up capital of RM3 million. For the year of assessment 2006, it has a tax loss of RM500,000, and a brought forward tax loss of RM200,000.

Company A wishes to surrender its loss to a related Company B in which it holds 80% shares. Company B, has a paid-up capital of RM2.8 million, and has a defined aggregate income of RM700,000 for the same year of assessment.

Assuming all other conditions are satisfied, the group relief in this instance will operate as follows:

Company A: (Surrendering company)		RM
Year of Assessment 2006		
Statutory business income		Nil
Unabsorbed loss b/f		200,000
Current year loss	500,000	
Less: losses surrendered to Company B (Limited to 50% of the current year loss)	250,000	250,000
Unabsorbed losses c/f		450,000

Company B: (Claimant company)	RM
Year of Assessment 2006	
Defined aggregate income	700,000
Less: losses surrendered by Company A	250,000
Total income	450,000

Illustration 2

If Company A in the above illustration surrenders its loss to two other related companies i.e. Company B and Company C (in both of which it holds 80% shares) and assuming further that

7 Sec. 44A(10) of the *Income Tax Act 1967*.

Company B has a defined aggregate income of RM200,000 and Company C has a defined aggregate income of RM120,000, the group relief will be given effect as follows (assuming all other conditions are satisfied):

Company A (Surrendering company)		RM
Year of Assessment 2006		
Statutory business income		Nil
Unabsorbed loss b/f		200,000
Current year loss	500,000	
Less:		
Losses surrendered to Company B	200,000	
Losses surrendered to Company C (Total losses surrendered limited to 50% of the available current year loss)	50,000	250,000
Unabsorbed losses c/f		450,000

Company B: (Claimant company)	RM
Year of Assessment 2006	
Defined aggregate income	200,000
Less: losses surrendered by Company A[8]	200,000
Total income	Nil

Company C (Claimant company)	RM
Year of Assessment 2006	
Defined aggregate income	120,000
Less: losses surrendered by Company A	50,000
Total income	70,000

Illustration 3

Company A has a current year loss of RM200,000 and Company B has a current year loss of RM300,000. Both companies wish to surrender their losses to Company C, which has an aggregate defined income of RM900,000.

Assuming all other conditions are satisfied, the losses may be surrendered and claimed as follows:

Company A: (Surrendering company)		RM
Year of Assessment 2006		
Statutory business income		Nil
Current year loss	200,000	
Less:		
Losses surrendered to Company C (Limited to 50% of the current year loss)	100,000	
Unabsorbed loss c/f	100,000	

Company B: (Surrendering company)		RM
Year of Assessment 2006		
Statutory business income		Nil
Current year loss	300,000	
Less:		
Losses surrendered to Company C (Limited to 50% of the current year loss)	150,000	
Unabsorbed loss c/f	150,000	

Company C: (Claimant company)	
Year of Assessment 2006	
Defined aggregate income	900,000
Less: Loss surrendered by Company A	100,000
	800,000
Less: Loss surrendered by Company B	150,000
Total income	650,000

What is the likely impact of this proposed amendment to group relief on company tax liability?

Group relief is nothing new. What is new is that it is now available to all companies with a paid-up capital of more than RM2.5 million ordinary shares. The corporate sector has been hankering for a group relief for some time, citing cost of doing business and the need to provide incentive for business with long gestation periods. Besides, high-risk ventures that require large capital outlays and initial high operation costs would benefit from this amendment. With tax laws allowing for group loss relief, these companies will be able to divert the losses made in the early periods to subsidiaries that are profitable–thus reducing the tax cost for the whole group.

This is also a further incentive for foreign direct investment to flow into the country. Most of the direct investment comes from developed countries that already have group relief legislation in place such as Australia, Netherlands and Britain. It is thus another step towards fitting in with global competitiveness.

What is the downside?

Plainly, it is not meant for the small and medium companies (SME). Incidentally, these SMEs already enjoy a two-tier corporate tax rate.[9] Besides being available only to the 'Big Boys', the group loss facility comes with a host of caveats. The condition of making the group relief mutually exclusive by not making it available to other companies like those enjoying pioneer status, shipping companies and those that had claimed reinvestment allowance under Schedule 7A, tends to make the incentive less than attractive.

8 Under sec. 44A(4)(c) the losses to be allowed shall not exceed the defined aggregate income of the claimant company for that year.

9 Currently a company with a paid up capital not exceeding RM2.5 million will be taxed on the first RM500,000 of the chargeable income at the rate of 20% and the balance in excess of RM500,000 would be taxed at 28%.

Furthermore, to enjoy the benefits of group relief, a company must make an election to have the loss surrendered and claimed. This election is irrevocable,[10] making it a daunting task for decision makers, not to mention the tax agents advising them.

The election package comes with an intimidating provision where if a surrendering company furnishes an incorrect amount of the adjusted loss surrendered, the surrendering company may be liable to a penalty equal to the amount of tax that had or would have been undercharged by the claimant company in consequence of the incorrect information.[11]

In the context of the self-assessment system where the taxpayer is already burdened with the task of determining his own chargeable income and the tax payable, this condition of irrevocability and the penalty consequential to a transfer of a wrong amount of loss, the decision to claim a group loss relief sounds to me like a decision to perform *hara-kiri*.[12]

The legislation further provides that in the basis year for a year of assessment if the Director General of Inland Revenue discovers that the adjusted loss (i.e. surrendered by one company and claimed by another company) ought not to have been deducted in arriving at the total income of the claimant company the Director General of Inland Revenue may in that year or within 6 years after its expiration make an assessment or an additional assessment in respect of that company in order to make good any loss of tax.[13]

Good times and bad times it seems, comes in seven-year cycles - if you believe Indian astrologers! And in income tax, particularly under the self-assessment, it appears to be so. Nothing is certain until the 7th year has passed – and even then, you must hold your breath for a long time if the Inland Revenue Board suspects fraud and willful default.[14]

Carry forward of Losses and Capital Allowances

Companies that have losses which are not fully deducted or set off against other income, and capital allowances that is not absorbed or not fully absorbed, can carry forward these losses and capital allowances to be set off against the income of the following year, or any subsequent year of assessment – i.e. it could be carried forward indefinitely. The losses can be set off against the statutory income from all business sources; and the capital allowance can be deducted from the same business source.

This feature of the tax law provided a simple and convenient tax planning mechanism to shift taxable income from a profit making entity to another business entity that is carrying an excess baggage of losses and capital allowances. Usually this is done by acquiring a loss making company and injecting the profitable business into this loss making company. The profits generated will be absorbed by the existing losses, thus giving the tax benefit to the acquirer.

In availing oneself of this attribute of the law, a change in the shareholders of the company was not a matter to be taken into account - until now. Effective from the year of assessment 2006, it is proposed that a 'Berlin Wall'[15] be erected under which:

- The amount of business losses and capital allowance ascertained for a year of assessment shall not be available for deduction in subsequent years of assessment if the shareholders of that company on the last day of the basis period for that year of assessment were not substantially the same as the shareholders of the company on the first day of the basis period for the year of assessment in which such amount would otherwise be deductible or given to that company; and

- The amount of the unabsorbed business loss and unabsorbed capital allowances in respect of a company for any year of assessment prior to the year of assessment 2006 shall not be allowed to be carried forward to the subsequent years of assessment if the shareholders of the company on the last day of the basis period for the year of assessment 2005 were not substantially the same as the shareholders of the company on the first day of the basis period for the year of assessment in which such amount would otherwise be deductible or given to that company.

The critical factor is the shareholders of the company–if the shareholders are not '*substantially the same*', then the losses and capital allowances determined in a relevant year will not be available for a deduction in the subsequent period. The shareholders are considered to be '*substantially the same*' as the shareholders of the company at any other date if on both of those dates:

- More than 50% of the paid-up capital of the ordinary shares of the company is held by or on behalf of the same persons; and
- More than 50% of the nominal value of the allotted shares in respect of the ordinary shares in the company is held by or on behalf of the same persons.

The cut off period is the year of assessment 2005. Under the proposed amendment, where the basis period of a company ends on or after 1 October 2005, the last day of the basis period for a year of assessment 2005 is deemed to be 30 September 2005 for the purposes of determining the shareholding. The amendment, which appears to be an anti-avoidance measure, effectively cordons off the losses and capital allowances ascertained prior to the year of assessment 2006.[16]

10 Under the new sec. 44A(2)(a)(iv) the surrendering company and the claimant company must make an irrevocable election to surrender or claim an amount of adjusted loss in the return furnished for that year of assessment under sec. 77A. Furthermore, under sec. 44A(8)(a) a claimant company that has made an election under sub-section 2 of sec. 44A cannot in that year elect to surrender its adjusted loss to any other claimant company. Similarly under sec. 44(8)(b), a surrendering company that has made an election under sec. 44A(2) cannot in that year elect to claim any adjusted loss from any other surrendering company.

11 Sec. 44A(9)(b).

12 '*Hara-kiri*' is a traditional method of ritual suicide by disembowelment practiced by the Japanese [Jap. *Hara* =the belly; *kiri*=to cut]

13 See sec. 44A(9)(a). The seven-year time limit however does not apply if the Director General of Inland Revenue discovers any fraud or willful default committed by any person, in which case an assessment can be re-opened at *any time* (sec. 91(3)).

14 See footnote 13.

15 This is the infamous wall erected by the Russians in the aftermath of the Second World War to prevent East Germans crossing over to West Germany.

16 See the special provisions to sec. 44 of the *Income Tax Act 1967 (as amended)*.

The possible implication of this new proposed legislation could be illustrated as follows:

Illustration 4

Company A has the following losses and capital allowances for the relevant years of assessment beginning the year of assessment 2004:

Year of assessment	Capital allowances (RM '000)		Losses (RM '000)	
	B/f	Current year	B/f	Current year
2004	300	100	80	30
2005	400	90	110	40
2006	490	70	150	60
2007	560	50	210	80
2008	610	60	290	70

In the year 2007, a group of investors found it viable to buy Company A. The new group took over the company and the shareholding changed 100% (in this illustrations referred to as the '*Old shareholders*' and the '*New shareholders*' respectively).

The result would be a disregarding of the losses and capital allowances ascertained in the year of assessment 2005; as well as the losses and capital allowances ascertained in the year of assessment 2006 to be allowed in the year of assessment 2008. The balances of the losses and capital allowance to be carried forward to the year of assessment 2008 would therefore be as follows:

Year of assessment		Capital allowances (RM '000)			Losses (RM '000)		
		B/f	Current Year	C/f	B/f	Current Year	C/f
YA 2004							
FDBP:* *Old shareholders*	LDBP:** *Old shareholders*	300	100	400	80	30	110
YA 2005							
FDBP: *Old shareholders*	LDBP: *Old shareholders*	400	90	490	110	40	150
YA 2006							
FDBP: *Old shareholders*	LDBP: *Old shareholders*	490 (Note 1)	70 (Note 3)	560	150 (Note 2)	60 (Note 4)	210
YA 2007							
FDBP: *Old shareholders*	LDBP: *New shareholders*	560	50 (Note 5)	50	210	80 (Note 6)	80
YA 2008							
FDBP: *New shareholders*	LDBP: *New shareholders*	50	60	110	80	70	150

** FDBP: First day of the basis period; **LDBP: Last day of the basis period*

Note 1 The capital allowances of RM490,000 b/f from the year of assessment 2005 would not be available for deduction in the year of assessment 2008 since the shareholders as at the first day of the basis period for the year of assessment 2008 is not the same as the shareholders as at the last day of the basis period for the year of assessment 2005.[17]

Note 2 Similarly the losses of RM150,000 b/f from the year of assessment 2005 would not be available for deduction in the year of assessment 2008 since the shareholders as at the first day of the basis period 2008 is not the same as the shareholders as at the last day of the basis period for the year of assessment 2005.

Note 3 The capital allowance of RM70,000 ascertained in the year of assessment 2006 would not be available for deduction in the year of assessment 2008 since the shareholders as at the first day of the basis period 2008 is not the same as the shareholders as at the last day of the basis period for the year of assessment 2006.

Note 4 Similarly the losses of RM60,000 ascertained in the year of assessment 2006 would not be available for deduction in the year of assessment 2008 since the shareholders as at the first day of the basis period for the year of assessment 2008 is not the same as the shareholders as at the last day of the basis period for the year of assessment 2006.

Note 5 The capital allowance of RM50,000 ascertained in the year of assessment 2007 would be available for deduction in the following year of assessment since the shareholders as at the last day of the basis period for the year of assessment 2007 is the same as the shareholders as at the first day of the basis period for the year of assessment 2008.

Note 6 The losses of RM80,000 ascertained in the year of assessment 2007 would also be available for deduction in the following year of assessment since the shareholders as at the last day of the basis period for the year of assessment 2007 is the same as the shareholders as at the first day of the basis period for the year of assessment 2008.

Businessmen certainly do not receive this legislation with much ecstasy because it brings about a negative and foreboding impact on the business scene. For one thing, it would obstruct tax planning by cash strapped companies that seek to reduce the tax cost by shifting profits to a loss making company. Financially challenged companies in a

17 Under the Budget 2006, a new paragraph 75A would be introduced to Schedule 3 of the *Income Tax Act 1967 (as amended)*. Under this amendment, any current year capital allowances which has not been so made to a company as ascertained under paragraph 75 for any year of assessment *prior* to the year of assessment 2006 shall not be made to that company for the purposes of sec. 42, if the shareholders of that company on the last day of the basis period for the year of assessment 2005 were not substantially the same as the shareholders of the company on the first day of the basis period for the year of assessment in which the allowances would otherwise be made to that company for the purposes of sec. 42. The amount that has not been made to that company would be disregarded for subsequent years of assessment.

group that seek to rationalize operations by moving and shifting profit-making operations with loss making operations would be affected too. In mergers and acquisition, the availability of losses and capital allowance are key factors since these losses hold a tax value for reducing costs. Besides genuine acquisitions of business interests by investors, seeking to acquire loss-making companies to reduce start up costs may be frustrated by this legislation. This would apply to both local and foreign investors.

Powers are however vested with the Minister of Finance whereby '*under special circumstances*',[18] a company may make application to the Minister to be exempted from the restriction imposed. It is not clear what the '*special circumstances*' are that may be considered for exemption.

However looking at both the legislations - one allowing group relief, and another that blocks the carrying forward of the losses and capital allowances - it is possible to speculate that these two provisions work in tandem. Thus, it would appear that the provision might not be applied to companies in the same group that are reorganizing, restructuring or amalgamating with a view to greater efficiency in operations. However to give effect to such moves, one must get the approval of the Minister of Finance. If so, this legislation appears to be quite reminiscent of the real property gains tax exemption provided for such corporate manoeuvres.[19]

Pioneer Status Companies with Tax Losses and Capital Allowances

As the law stands, pioneer status companies are not allowed to carry forward unabsorbed losses and unabsorbed capital allowances incurred during the pioneer period to the post pioneer period. In such a situation, the unabsorbed losses and capital allowances would be permanently lost for tax purposes.

A pioneer company, which is unable to utilize the unabsorbed losses and the unabsorbed capital allowances, is actually worse off than its non-pioneer counterpart is. At some stage, companies that were granted pioneer status sought to surrender their pioneer status in favor of the more advantageous tax facility like Investment Tax Allowance or even the plain and simple Reinvestment Allowance under Schedule 7A of the *Income Tax Act 1967 (as amended)*.

The 2006 Budget proposes that any unabsorbed tax losses and unabsorbed capital allowances incurred by companies during the pioneer period be allowed to be carried forward and deducted from the post-pioneer income of the business relating to the same promoted product or promoted activity. This should be a true relief for such companies.

CONCLUSION

The group relief has been extended to all sectors but with the quantum limited to 50% of the current year business loss against the profit of another company within the group. In addition, unabsorbed losses and capital allowances of a pioneer company can now be carried forward to the post pioneer period to be set off against the same source of income. These are significant measures. The Malaysian tax system as regards losses is now in line with that of more advanced countries like Australia and England. This bodes well for cross border transactions and foreign direct investment into Malaysia in the ever expanding and fiercely competitive globalization landscape.

On the other hand, losses and capital allowances cannot be carried forward if the shareholding in a company changes by more than 50%. This legislation, while not immediately palatable, is apparently designed to prevent fiscal mischief by irresponsible companies, while at the same time plugging a possible revenue leak in this area.

Overall, I think businessmen and companies in general should not be at a loss with this 2006 Budget.

The Author

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[18] Sec. 44(5D) - '*...where there is a substantial change in the shareholder of a company...the Minister may under special circumstances exempt that company from (this) provisions...*'

[19] Under paragraph 17 of Schedule 2 of the *Real Property Gains Tax Act 1976*, if a company, with the prior approval of the Director General of the Inland Revenue, transfers assets between companies in the same group to bring about greater efficiency or assets are transferred in a scheme of reorganization, reconstruction or amalgamation and so on, the transfers will be treated as a disposal on which the transferor company receives no gain or suffers no loss.

OFFSETTING:

Effect on Tax Computations and Tax Instalments

BY KENNETH YONG

Introduction

In the frenzied labyrinth of tax rules and accounting standards, it is amazing how some small detail - which is insignificant and easily overlooked in the midst of other more attention-grabbing issues-can create practical difficulties in tax computations and tax payments.

One such issue is *offsetting*. For the tax practitioner, offsetting can stir up trouble in two main areas: tax computations, and tax instalment payments.

Offsetting under accounting standards

Under accounting principles, offsetting is generally undesirable and is usually avoided. This is to ensure that financial reporting is true to the virtues of understandability and reliability. Para 32 of FRS 101 (Presentation Of Financial Statements) states:

"Assets and liabilities, and income and expenses, shall not be offset unless required or permitted by a Standard or an Interpretation."

An almost identical set of wording is echoed in MASB 1 Para 33.

Offsetting is the act of netting off an asset against a liability, or netting off income against expense, and presenting only the net figure in the financial statements.

The way information is presented in the accounts can affect the tax treatment. More information usually leads to better appreciation of the transaction and enables the tax practitioner to adopt an appropriate tax treatment.

However, offsetting hides details. Transactions that contain offset-values can become less clear, and this can muddle up the tax treatment.

In the era of self-assessment, full disclosure and heightened transparency is crucial to ensuring the right items are added back in the tax computation, and that income is being taxed under the right sections. Offset-values can impair a tax practitioner's ability to do both of these.

MASB 1 on offsetting

Prior to FRS 101, MASB 1 Para 36 identified the following areas where offsetting is required:

a) *gains and losses on the disposal of non-current assets, including investments and operating assets, are reported by deducting from the proceeds on disposal the carrying amount of the asset and related selling expenses;*

b) *expenditure that is reimbursed under a contractual arrangement with a third party (a sub-letting agreement, for example) is netted against the related reimbursement.*

Sub-letting

Following the example in point (b) above, MASB 1 requires rental expense and sub-rental income to be offset. Prior to 2004, this can be a nightmare for tax practitioners because of its inconsistency with tax rules of the time.

Sec. 4 of the *Income Tax Act 1967* requires income to be segregated into various sources, and non-business rental income is to be taxed separately under sec. 4(d). This means that sub-rental income should *not* be offset for tax purposes, but instead, should be taxed separately under sec. 4(d) as non-business rental.

However, MASB 1 requires only the net figure to be presented. This offset-value is not tax-friendly, as preparers of tax computations can easily overlook that there is actually a gross rental expense and a sub-rent income.

As an example, imagine a company incurring rental expense on a large office space, and sub-renting out part of the excess space to earn sub-rent income.

In such rent-and-sub-rent arrangement, MASB 1 requires the rental expense and sub-rent income to be offset, and only the *net* rental expense is presented in the financial statements.

But tax rules require that the *gross* rental expense be deducted against the business source (sec. 4(a)), while the sub-rent income be separated and taxed as sec. 4(d) income.

Illustration 1 highlights some potential tax effects.

Illustration 1: Tax effect of presenting rental expense and sub-rent income as net and gross

		Sub-rental income net off	Sub-rental income re-grossed	
Profit before tax		48,000	48,000	
Adjustments:				
Non deductible expenses		6,000	6,000	
Sub-rental income [sec. 4(d)]		-	**(36,000)**	**
Interest restricton		12,000	12,000	**
Adjusted income - business		66,000	30,000	
Capital allowances				
b/f and current claim	40,000		-	
Utilised		(40,000)	(30,000)	
Statutory income - business		26,000	-	
Unabsorbed business losses				
b/f	20,000			
Utilised		(20,000)	-	
Sec. 4 (d) - sub-rental income		-	**(36,000)**	**
Restrcited interest		no income to deduct	(12,000)	**
Total taxable income		6,000	24,000	
		Diffrent tax results		

Assumptions:
- General purpose borrowings have been taken by the taxpayer.
- The taxpayer owns other commercial properties which have commenced generating rent but are temporarily not rented out.
- The entire restricted interest is re-allocated to the rental source (commercial properties).

The presence of unabsorbed capital allowances, unabsorbed business losses and interest restriction can create a different tax outcome when gross values are used instead of offset-values. In such events, a tax practitioner who follows the accounting figures without further scrutiny or query, could compute incorrect tax figures.

Subsequent development - *Public Ruling 1/2004*

This problem was addressed and largely solved by the introduction of *Public Ruling 1/2004* - Income From Letting Of Real Property. Para 10 of Public Ruling 1/2004 states:

"Where a building is used for the purpose of a business and part of the building is sublet, the rent arising from the subletting is treated as part of the existing business source."

Thus under *Public Ruling 1/2004*, rental expense and sub-rent income are to be designated to the same business source. Applicable from year of assessment 2004 onwards, this concession effectively modifies the tax treatment to be in line with the accounting presentation of offsetting.

Tax practitioners need not re-gross the sub-rental income; simply following the accounting figures will cause the treatment to be tax compliant.

(2006 Budget redefined an Investment Holding Company (IIHC) as a company that derives at least 80% of its gross income from holding of investments. Thus, additional care must be taken to assess if the taxpayer is an IHC under 2006 Budget, and if so, the rental expense and sub-rent income will both be taken up under sec. 4(d).)

Subsequent development - FRS 101

However, this quick-fix will be short lived. FRS 101 (which becomes effective from 1 January 2006), will bring a subtle but potent change to rules on offsetting.

Under FRS 101, the example on offsetting rental expense and sub-rental income (item (b) above) has been removed. This means that with effect from 1 January 2006, rental expense and sub-rental income are to be presented separately on the profit and loss account, and not as an offset-value.

Thus, following *Public Ruling 1/2004*, tax practitioners will need to be vigilant and designate the sub-rent income to the business source if the building is used for the main business.

Multiple sets of rules

Because of the interaction of different accounting and tax rules, practitioners will need to apply different treatment for each Y/A where there is a change of such rules.

2004 to 2006 may seem a short stretch of time, but it betrays the variations in which a rent-and-sub-rent transaction is to be treated:

(1) Prior to 2004, the presentation under MASB 1 is to offset rental expense with sub-rent income. Proper tax accounting requires re-grossing and designating sub-rent income to sec. 4(d) source;

(2) For 2004 and 2005, *Public Ruling 1/2004* deems sub-rent income to be part of the business source. So re-grossing per (1) above does not need to be done;

(3) In 2006 and beyond, FRS 101 which supersedes MASB 1, does not specifically allow offsetting rental expense and sub-rent income. Thus, to comply with *Public Ruling 1/2004*, sub-rent income (which is now classified separately on the P&L) will have to be designated to the main business source for tax purposes.

Tax practitioners will need to familiarise themselves with 3 sets of rules pertaining to sub-rent offsetting.

Offset payments

Another form of offsetting that commonly occurs is netting off tax overpayments of one year against tax instalments of a future year. Because the cash inflows and outflows are expected to be settled with the same taxing authority (ie the Inland Revenue Board), offsetting is allowed in the accounts - there is a legal right to offset.

However, while this sounds simple in the books, the practical side of offsetting can sometimes be more difficult.

Many taxpayers fear one sore point of over-paying taxes - getting back a tax refund can take a long time. Therefore, corporate tax payers prefer to offset any tax overpayments against future tax instalments.

A real problem can occur if the IRB refuses to allow offsetting of overpayments (eg. citing that refund is being arranged), whilst insisting that future instalments have to be paid even though the refund is still in the pipeline.

During a seminar organised by MIT on 15 March 2004, it was brought to the attention of the IRB officials present that certain corporate taxpayers were not allowed to offset their tax overpayments (per Form C) against their CP204 tax instalments, or that offsetting was only limited to 2 or 3 tax instalments. (However, this is no longer the current practice.) It was also brought up that as a point of law, any overpayment is the legal property of the taxpayer who should have the right to elect for a tax refund or for offsetting against future instalments.

Since then, the IRB has taken a more liberal (and accommodating) approach by allowing corporate taxpayers to offset tax overpayments against future tax instalments.

Currently, the IRB (Jalan Duta branch) issues a standard-type letter to approve offsetting, indicating the following main points:

(i) Offsetting is approved for future CP204 instalments for up to 2 future months.

(ii) If a refund has not been received, the approval for further offsetting is extended automatically.

While this approach is both practical (no follow-up letter required) and taxpayer-friendly (allows offsetting), it also shifts the responsibility of monitoring the refund and instalment payments to the corporate taxpayer, who must ensure all CP204 instalments are made good upon refund.

By officially allowing only 2 months of offsetting (per item (i) above), the IRB is hinting that it expects to issue a cheque refund within 2 months. This is an ambitious, but very welcoming policy in line with the objectives of setting up the Fund for Tax Refund under 2005 Budget.

From the wording of the standard letter issued, the IRB seems to be gearing toward speedier tax refund - an approach that will attract much interest and applauds from taxpayers.

CONCLUSION

The issue of offsetting provides yet another example to demonstrate that accounting standards are not always tax-friendly. This places a heavy burden on tax practitioners who must not only be conversant in tax law, but must also have sufficient appreciation of accounting standards to pick out elusive, but fundamentally crucial, issues (eg. offsetting).

Given the introduction of 21 new FRS standards in 1 January 2006, it will be interesting to see just how these future accounting standards will complicate the tax treatment.

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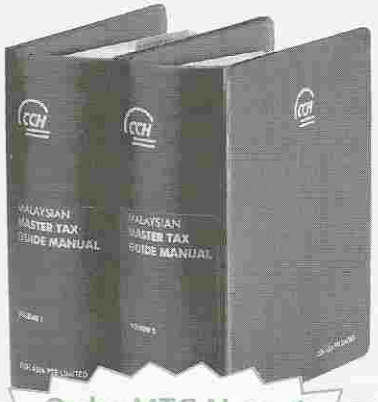

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Time for Leave Passage to move on...

BY SG TOH

I have long been interested in dissecting the issue of Leave Passage as it is one of those issues that straddle both individual and corporate tax implications. In this article, I intend to firstly, illumine the current tax position of Leave Passage and secondly, to put forward my views on why the continual disallowance of Leave Passage cost is no longer relevant in our present day context.

The Public Ruling 1/2003 issued by the Inland Revenue Board (IRB) on 5 August 2003, defines Leave Passage as "...traveling during a period of absence or vacation from duty or employment...". Based on this definition, it seems that any form of "traveling" other than for business purposes is deemed to be a Leave Passage expenditure under Public Ruling 1/2003.

Sec. 13(1) of the *Income Tax Act 1967* (the Act) goes on to state that any benefit or amenity granted to the employee (by the employer) is treated as part of the gains or gross profits of the employment, such as fixed allowances, Leave Passage benefits, etc., and is therefore taxable. However, sec. 13(1)(b)(ii) of the Act states that not all benefits in the form of Leave Passage will be included as part of the assessable income of the employee.

Leave Passage benefits that would **NOT** form part of the assessable employment income of the employee (i.e. not taxable), are as follows:

(i) Leave Passages for travel within Malaysia not exceeding three times in any calendar year; or
(ii) one Leave Passage for travel between Malaysia and any place outside Malaysia in any calendar year, limited to a maximum value of RM3,000.

The exclusion of the Leave Passage benefit, however, is confined only to the employee and members of his immediate family.

Sec.13(1)(b)(ii) of the Act however does not in any way affects the non-deductibility of such expenses in a company's tax computation.

Moving on to sec. 39(1)(m) of the Act, which further states that any expenditure incurred by an employer in the provision of a benefit or amenity to the employee consisting of a Leave Passage within or outside Malaysia is NOT allowed as a tax deduction in ascertaining the adjusted income of the company for the basis period. This disallowance under sec. 39(1)(m) had been introduced in the 1988 Budget as a measure to tighten the types of expenditure allowed as tax deductions and came into force in Year of Assessment 1989.

In short, based on the above provisions, it is quite plausible for both the individual and the employer to be subjected to income tax for the same expenditure incurred. The former, if the Leave Passage exceeds RM3,000, and the latter, if providing such a benefit to the employee as part of the employment package. As an illustration, let us refer to an example of the Public Ruling 1/2003 as below:

Example 6 of Public Ruling 1/2003

Scenario:
Puan Rina is entitled to a yearly overseas Leave Passage benefit of RM10,000 and local Leave Passage benefit of RM5,000 according to the terms of her employment agreement. In the year 2003, Puan Rina went on an overseas holiday trip with her husband to Italy and made a claim for overseas Leave Passage cost of RM7,500. She also went on four local holiday trips to Pulau Langkawi, Pulau Tioman, Pulau Pangkor and Pulau Redang with her husband and three children in the year 2003 and made a claim for local Leave Passage cost of RM500 for each trip.

Outcome:
Puan Rina is exempted from tax on the overseas Leave Passage benefit of RM3,000 in the year 2003 for the year of assessment 2003 but would be taxed on the remaining amount of RM4,500. She is also exempted from tax for up to three local leave passage benefits amounting to RM1,500 in the year 2003 for the year of assessment 2003 but would be taxed on the remaining local Leave Passage benefit. (Note: If there are four or more local leave passages in the same year, then the three most expensive passages are exempt.)

Moreover, neither will Puan Rina's employer be entitled to a corporate tax deduction on the leave passage benefit of RM10,000 (overseas passage) and the RM5,000 (local passage).

Having established the basics, the main point of contention of this article is the lack of justification for the continual disallowance of Leave Passage as a non-tax deductible expense in the employer's books.

I put forward 4 reasons for the **abolishment of the non-deductibility of Leave Passage**, as follows:

i. Economic Justification

From an economic perspective, the issue of allowing such expenditure as a tax deduction is not a new concept. For instance, considering the following excerpt extracted from the economic stimulus package announced by the government on 21 May 2003, "...Currently, employees are given income tax exemption on Leave Passage for domestic travel provided by employers. However, income tax

deduction is not given to employers for expenses incurred on such Leave Passage. To further encourage domestic tourism *(emphasis added)*, employers will be given double deduction for such expenses for a period of one year from 1 June 2003…".

Therefore in 2003, **the following measures** were initiated by the government to spur the lagging local "tourism sector":

a. Forfeit the loss of revenue from the allowance of domestic Leave Passage; and
b. A temporary "double" expense claim on domestic Leave Passage benefits provided to staff.

Based on the above, it is therefore rather perplexing as to why we need to continue to restrict the claim for Leave Passage benefits provided by companies to its staff, when in fact, the partial removal of such restriction was seen as a proactive economic measure needed to stimulate an integral sector of the economy.

The tourism industry of Malaysia remains as a significant contributor to the economy in terms of foreign exchange earnings. In 2003, the industry generated RM21.3 billion from 10.6 million tourists.

The Q1 Update of the Malaysian Economy for 2005 states that wholesale and retail trade, hotels and restaurants expanded by 7.7%. This was spurred by sustaining consumption during the festive seasons and higher tourist arrivals and this growth (4.6%) in tourism has resulted in higher average hotel occupancy rates of 60.7%.

Imagine the direct and indirect advantageous that can be achieved for the people and the economy if companies were to reward their staff Leave Passages.

ii. Original rational for introducing Leave Passage

With reference to the 1988 Budget Speech, the measure to restrict Leave Passage benefits was primarily introduced in 1989 "…in order to streamline and control tax deductions and personal expenses…" as there was abuse of such claims.

But this issue of abuse of claim is no longer pertinent under the new Self Assessment System as now the onus or responsibility for proper disclosure and claim of legitimate expenses is befallen on the taxpayer. If the taxpayer seeks to recklessly evade tax by incorporating his/her personal expenses into the company's expenditure, then it is my opinion that this action would cause the taxpayer liable for penalty payments under a tax audit and/or investigation.

Hence, judging from the Self Assessment System point of view, the safeguard measure introduced in 1989 would be unnecessary as the burden of proof on the commercial validity of any expenses lies on the shoulders of the taxpayers who seek to make a claim for tax deduction. In the event there is an abuse, the existing provisions of sec. 140 of the Act are more than adequate to deal with such delinquent taxpayers who unethically use the employer to pay for their personal expenses.

iii. In line with Government Policies

The recent move by the government to reduce the number of working days to five days for government servants was predominantly for the purpose of allowing the government servants to have the luxury of going somewhere for a weekend holiday and spending money.

It does seems ironic that on one hand we have a government policy to promote the local tourism industry by granting more time for weekend holidays but on the other hand, we have a tax law that refrained from compensating employers who reward their staff with paid holidays and company trips.

The Public Ruling 1/2003 indicates that any forms of traveling (other than for business purposes) will be treated as Leave Passage. Moving on these lines, an employer will be "deemed" to have incurred Leave Passage, if the employer reimbursed "petrol/toll charges" incurred by the staff for a company trip to a local tourists attraction unless there was some element of "business or training" carried out during the trip.

We do not think that the drafters of Public Ruling 1/2003, would not have intended that each employer insist that a "10 minute staff meeting must be convened during the company picnic" in order to qualify that the company picnic has an element "…duty or employment…" and therefore the traveling reimbursements incurred would not be defined as Leave Passage expense as per the Public Ruling.

iv. Case law may be distinguish

With reference to the existing case law such as *ST Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri ((1995) 2 MSTC 3,440) and KHK DMB & B Sdn Bhd v Ketua Pengarah HDN ((2000) MSTC 3,201)* it was firmly established that the providence of Leave Passage is not an expenditure incurred in the production of a company's business activity and therefore cannot be allowed a tax deduction under sec. 33(1) of the Act. As in the case of *ST Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri ((1995) MSTC 3,440)*, Harun, J stated that "…To qualify for deduction under sec. 33 of the Act, the expenses must be wholly and exclusively incurred in connection with the production of gross income of the taxpayer…Being private and vocational, the expenses cannot be both wholly and exclusively incurred in connection with the production of gross income of the Appellant…."

I would not in any way consider myself to be sufficiently bold to comment on the *ratio decidendi* raised in the above cases but I do wish to put forward that upon a thorough reading of either case, it does appear to me that another crucial common factor propounded in both cases. The factor I refer to is that the "recipients" of the Leave Passage benefit had been able to either directly or indirectly, "control/influence" the administration of the company.

Hence, it is possible to contend that the payment of Leave Passage benefits provided by the above companies were seen in part by the learned judges as the imposition of "personal" expenses by the active decision makers of the companies and there was no clear commercial justification to warrant such expenses in the companies books. With this assumption, it then given rise to another question as to whether or not a similar conclusion would have been reached by the learned judges if the Leave Passage was actually provided to the recipient/(s) who DID NOT have either direct or indirect influence in a company? Possibly not, as such expenses "could" have been perceived as being commercial valid expenses under an "independent" contract for service.

As to the main issue of the relevance of Leave Passage in relation to the income generation activities of a company (as highlighted in the above cases), one cannot deny that in this shrinking dominion of globalisation and the free movement of skilled manpower among nations, the inclusion of Leave Passage as part of the remuneration package is the expected norm by expatriate professionals seeking employment in a foreign country. It seems quite ironic, if "dental expenses provided to families" are recognised as an acceptable company benefit for the staff but contend that a "paid flight home" for expatriate staff is not deemed acceptable company benefits because it is classified as an expense that has no connection with income generating activities of the company.

It is my opinion that the tax legislation should accommodate or adjust to the changing conditions of a global economy. In practice, in order to achieve higher income and gain competitiveness, companies in many countries recognise Leave Passage as an acceptable mode of remuneration to motivate or draw skillful and competent professionals to be their employees. Realising this, country such as Singapore allows 20% of the home Leave Passages for one passage each for a foreign employee and his wife and 2 passages for each child annually.

One would not want to compare between Singapore and Malaysia, but it does reinforce the point that Leave Passage is an acceptable mode of remuneration and is linked to the income producing activities of a company.

v. Flexibility to Reward staff

Lastly, I believe that companies should be given the flexibility to entice competent to be their employees by providing "paid-holidays" and the expenses incurred should be tax deductible. .

In practice, it is more tax advantageous for a company to pay "cash" (upon which the employee will be taxed) than for the company to provide the staff a Leave Passage benefit so that the employee can claim partial personal relief. It is therefore difficult to comprehend the rationale to retain sec. 13(1)(b)(ii) of the Act (which allows the individual taxpayer a partial personal deduction) in view that company would be reluctant to incur Leave Passage expenditure, due to the restriction under sec. 39(1(m) of the Act, which has made relief under sec. 13(1)(b)(ii) more or less, inept.

CONCLUSION

As a summary, my contention that employers should be allowed a tax deduction for Leave Passage benefits are as below

i. That, such a measure has been recognised in 2003 as an economic measure to stimulate the domestic tourism industry;
ii. That, Leave Passage should be considered as acceptable Benefit-In-Kind for employees if remuneration is based on valid commercial justifications;
iii. That, there is no possibility for evasion or abuse under the Self Assessment System as the burden for proper disclosure and claim, lies in the hands of the taxpayers; and
iv. That, the allowance for personal relief under sec. 13(1)(b)(ii) is seldom applied or used because companies are reluctant to provide Leave Passage cost which is not tax deductible

Based on these factors, I wish to contend that Leave Passage should be allowed a tax deduction in the employers tax computation and sec. 39(1)(l) of the Act to be amended in order to allow the employers to grant Leave Passage benefits as part of a contract for service.

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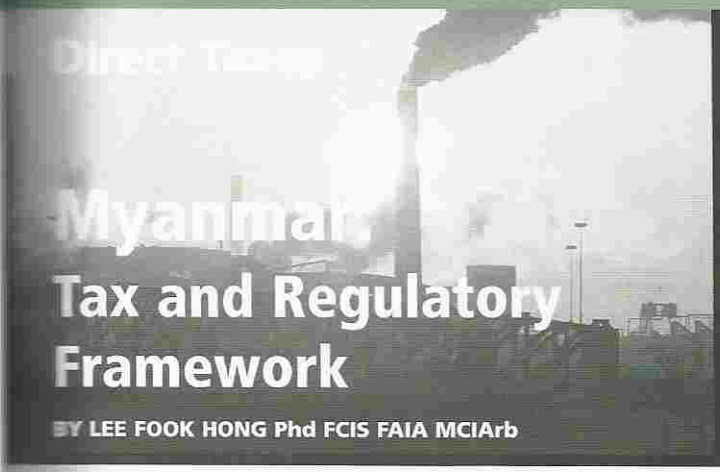

Myanmar Tax and Regulatory Framework

BY LEE FOOK HONG Phd FCIS FAIA MCIArb

After adopting the market oriented economic system in 1998, Myanmar has become one of the newly emerging economies in Asia. Economic reform and social stabilisation measures have been undertaken and implemented continuously towards a free market economy. This is to allow foreign direct investments and to encourage private sector involvement in trades or industries which are previously restricted to the State. Myanmar has continuously attracted an increasing number of foreign investments. Singapore, United Kingdom, Thailand and Malaysia are the major investors in Myanmar.

The Laws and Investment Regulatory Framework

The commercial and tax laws of Myanmar are based on the English legal system. English language is widely used in official documentation and many areas of legal framework.

One of the first set of laws on investment promulgated by the State Law and Order Restoration Council is the *Union of Myanmar Foreign Investment Law* (FIL) which serves to induce foreign investments and to boost investments particularly in the private sector.

Foreign investors can set up their businesses either in the form of a wholly foreign-owned or a joint venture. Foreign equity can be up to 100 per cent but not lower than 35 per cent if it is a joint venture. Under the FIL, tax holiday, exemptions and other incentives are granted.

To be eligible for investment under the FIL, the minimum amounts of foreign capital required are US$500,000 for an industry and US$300,000 for a service organization. Business activities allowed under the FIL were announced by the Myanmar Investment Commission (MIC) vide Notification No. 1/89. Business activities which are not included in the Notification will be considered on a case-by-case basis.

Types of business vehicles for foreign investments

Business vehicles for foreign investors can be one of the following types of business entities:-

a) Partnerships - The rights and obligations of the partnership are based on the agreement between the partners and governed by the *Partnership Act of 1932* (the Act). The Act limits the number of partners to not more than twenty. All partnerships in Myanmar are of unlimited liability. Where no stipulation is made for the period of time, the partnership will be dissolved when all partners agree to do so.

b) Limited liability company - most foreign enterprises incorporate a limited company when doing business in Myanmar. Such a company could be a foreign company registered in Myanmar or by means of a branch office or representative office.

There are minimum capital requirements for foreign companies and branches:-

Industrial company - foreign currency equivalent to Kyat 1,000,000
Services company - foreign currency equivalent to Kyat 300,000

All foreign companies and branches, other than those operating under the *Special Company Act*, are required to obtain a Permit before registration. There are two main types of company: a private and a public limited liability company and their requirements are as follows:-

- In regard to a private limited company, transfer of shares is restricted. The public cannot be invited to subscribe for shares and the number of members is limited to fifty.

- As regards to a public limited liability company, the number of shareholders must be at least seven. The company, after registration, must apply for a Certificate of Commencement of Business to start its business operation.

- *Special Company Act*: This law applies to joint equity ventures between foreign investors and the State.

Taxation

a) Corporate Taxation
A resident company is taxed on its income derived from sources both within and outside Myanmar at a flat rate of 30 per cent. For a non-resident branch company, income tax is payable at 35 per cent or at progressive rates of 3 to 50 per cent, whichever is the higher. A non-resident taxpayer is only taxed on income derived in Myanmar.

In addition to income tax, there are capital gains tax and commercial tax, which are indirect taxes.

For a resident company, the rate of capital gains tax is 10 per cent while the rate for a non-resident company is 40 per cent.

b) Tax year
The tax year (basis year) is from April 1 to March 31 of the following year. The accounting year is required to be in line with the tax year. The income tax is imposed on preceding year basis.

c) Residence
A company is regarded as a resident and subject to tax if it is incorporated in Myanmar. A branch of an overseas

company, on the other hand, is treated as a non-resident since its control and management are outside Myanmar.

A resident foreigner or a resident citizen is subject to tax on all income both from sources within and outside Myanmar. In the case of a foreign enterprise operating under the *Union of Myanmar FIL*, the tax is payable only on income derived from sources within Myanmar.

A non-resident foreigner is subject to tax on all income from sources within Myanmar.

A resident foreigner is:-

i) a foreigner who lives in Myanmar for not less than 183 days during the basis tax year.
ii) a company which is formed under the *Myanmar Companies Act* or any other existing Myanmar Law wholly or partly with foreign shareholders.
iii) an association of persons other than a company formed wholly or partly with foreigners and where control, management and decision making of its affairs are situated and exercised wholly in Myanmar.

A branch company is treated as a non-resident for income tax purposes. As a non-resident, a branch is assessed on income derived from within Myanmar in one of the following manners to be decided by the Inland Revenue Department :-

- its branch profits ;
- a proportionate world profit basis ;
- a deemed profit basis, that is, a reasonable percentage of tax on turnover, which may vary from 5 to 10 per cent ; or
- any basis which the Inland Revenue Department considers to be reasonable.

d) Taxation of individuals
An individual is a tax resident if he spends a total of 183 days or more in Myanmar in any tax year.

An individual employed by an enterprise under the FIL is regarded as a resident and the period of stay rule does not apply.

A resident is assessable on his total world income, whereas a non-resident is assessed on his income derived in Myanmar only. A non-resident individual does not enjoy a basic allowance, family allowance or insurance premium allowance.

The salary income is computed at progressive tax rate of 3 to 30 per cent for resident individuals while non-resident individuals are assessed at a flat rate of 35 per cent.

Salary (employment) income includes tax paid by the employer, all allowances, benefits in kind and perquisites. Dividends are exempt and excluded from the assessment.

Capital assets, subject to capital gains tax include immovable property and motor vehicles, but exclude jewellery. The rate for capital gains tax is 10 per cent for resident individuals and 40 per cent for non-resident individuals.

From the total income, a basic allowance of 20 per cent of total income subject to a limit of Kyat 6,000 is allowed. Wife and children allowances and life assurance premium for the employee and spouse are deductible. If the wife has no assessable income in the tax year, the husband can claim an allowance by way of relief of Kyat 2,500.

e) Withholding tax
Payment of income such as interest, royalties and government contracts payments are subject to withholding tax. The rates of withholding tax are as follows:-

Types of Income	Resident Tax Rate (%)	Non-Resident Tax Rate (%)
Interest	15	15
Royalties	15	20
Government contracts	3	3.5

There is no withholding tax on dividends and remittance of branch profits. The lower tax rates may apply for income arising from countries which have entered a double tax agreement with Myanmar.

f) Repatriation of profits
There are no restrictions on the repatriation of profits if a company operates under the FIL and earns foreign exchange income.

g) Calculation of taxable income
Taxable income is the total income from all sources other than the capital gains, less the expenses incurred solely and exclusively for the purposes of business. Depreciation is allowed in accordance with stipulated rates. There is no special deductions for research and development. Generally, non-allowable items for tax deduction include employees' personal expenses, capital expenditure and expenses not incurred in the production of income.

Amortisation of goodwill is not allowed. Interest expense for which no withholding tax has been paid is also not deductible for tax purposes. Approved donations up to 25 per cent of net income are permissible deductions.

Foreign income of a resident taxpayer is also taxable and no credit will be given for taxes paid abroad except the income deriving from countries which have double tax treaties with Myanmar.

Foreign branches are taxed only on income derived from within Myanmar. Income derived from outside Myanmar is not taxable on foreign branches.

Tax losses not being a capital loss can be used to set off against profits from other sources of income in the same year. Unabsorbed tax losses can be carried forward for three years to set off future profits.

Capital gains arising from the disposal of fixed assets are calculated as sale proceeds minus the depreciated cost of the assets.

Capital loss can be set off against capital gain in the same year but it can not be carried forward.

h) Tax incentives
Under the *Foreign Investment Law*, a tax holiday of three years is granted from the year of commencement of production of goods and services and may be extended for a reasonable period depending on the success of the enterprise in which the investment is made.

Foreign investors may also apply for the following tax incentives:

i) exemption from income tax on profits of the business if they are retained in a reserve fund and reinvested therein within 1 year after the reserve is made;

ii) accelerated depreciation in respect of machinery, equipment, building or other capital assets used in the business, at the rate decided by the Inland Revenue Department;

iii) relief from income tax up to 50 per cent on profits accrued from the export if the goods produced by the foreign investors are exported.

i) Indirect taxes
The main indirect tax in Myanmar is commercial tax. Commercial tax is a turnover tax levied on goods and services. The tax is imposed on a wide range of goods and services produced or rendered within the State and the imported goods from abroad. Except for trade, the tax imposed as an ad valorem single tax, that is, at the point of sale of producer or manufacturer for domestically produced or manufactured goods. The tax payable for imported goods is to be collected by the Customs Department in the same manner as the customs duty is collected.

Commercial tax is levied according to the schedules appended to the *Commercial Tax Law*:-

i) Schedule I details tax-free items comprising 65 essential and basic commodities;

ii) Schedules II to V carry rates ranging from 5 per cent to 25 per cent depending on the nature of the goods. The tax will be charged on the landed cost of the imported goods and on the sale proceeds of the goods produced within the State;

iii) Schedule VI is for specific type of commodities such as cigarette, fuel, oil, liquor, pearl, jade and gems on which tax is chargeable at rates ranging from 30 per cent to 200 per cent;

iv) Schedule VII is applicable to services including trade ranging from 5 per cent to 30 per cent.

Briefly the commercial tax rates are as follows:-

Imported goods (on landed cost)	- 0 to 25 per cent
Special goods	- 30 to 170 per cent
Manufactured goods (on sales)	- 0 to 200 per cent
Trading - local (on sales)	- 5 per cent
Export (on sales - FOB)	- 5 per cent
Passenger transport	- 8 per cent
Hotel/lodging	- 10 per cent
Restaurant	- 10 per cent

There are provisions for the exemption of commercial tax whenever such exemption is considered appropriate, particularly as incentives for newly established businesses and exports.

Other taxes such as stamp duty, property tax, land tax, excise duty, customs duty are payable according to the rates prescribed.

CONCLUSION

Myanmar, as one of the newly emerging economies in Asia, offers a wide range of investment and business opportunities to foreign investors.

Besides its rich natural resources and cultural heritage, Myanmar provides a spectrum of tax incentives to attract foreign investments.

Myanmar believes in doing business in the light of mutually beneficial economic cooperation for the long term. Both Malaysia and Singapore are Myanmar's major trading partners and investors. As there are opportunities available to foreign entrepreneurs, those who are interested in doing business in Myanmar should visit the country and seek advice from businessmen who are already in that country and professionals with experience in advising on tax and investment laws of Myanmar.

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E-COMMERCE: Tax Problems and Challenges

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Introduction

E-commerce has introduced to the world a virtual living whereby from the comfort of the living room, customers can purchase books, music or anything they fancy by pressing a button on the mouse. E-commerce is the exchange of information across electronic networks, at any stage in the supply chain, whether within an organisation, between companies and consumers, or between the public and the private sectors, whether paid or unpaid (Basu, 2001). In other words, e-commerce in many ways has changed the way of doing business.

In recent years, the trend of e-commerce has become the more preferred way of doing business. It is the instrument used for business communication across national boundaries. More and more companies are taking the opportunity to expand businesses through this new mechanism. The rapid growth in e-commerce has revolutionised and expanded global retail businesses. Unfortunately, as e-commerce business deals are transacted over the cyberspace, whereby the physical presence of trade is not in existence, this has thus given rise to tax collection problems.

E-Commerce and Tax

The borderless nature of cyberspace, emergence of virtual companies and web-based intermediaries and the use of the domain name as a form of identity has complicated the process of identifying the physical location and identity of a company (Sithamparam, 2001). Hence, e-commerce has created a big challenge to traditional taxation concepts. This is mainly because the source of income and the residence concept have always been the key principles in taxation which are being manipulated. As a result, the task of taxing the Internet businesses is daunting as national boundaries are meaningless on the cyberspace, and the data flowing through the vast annals of the Internet is intangible (Vohra,2004).

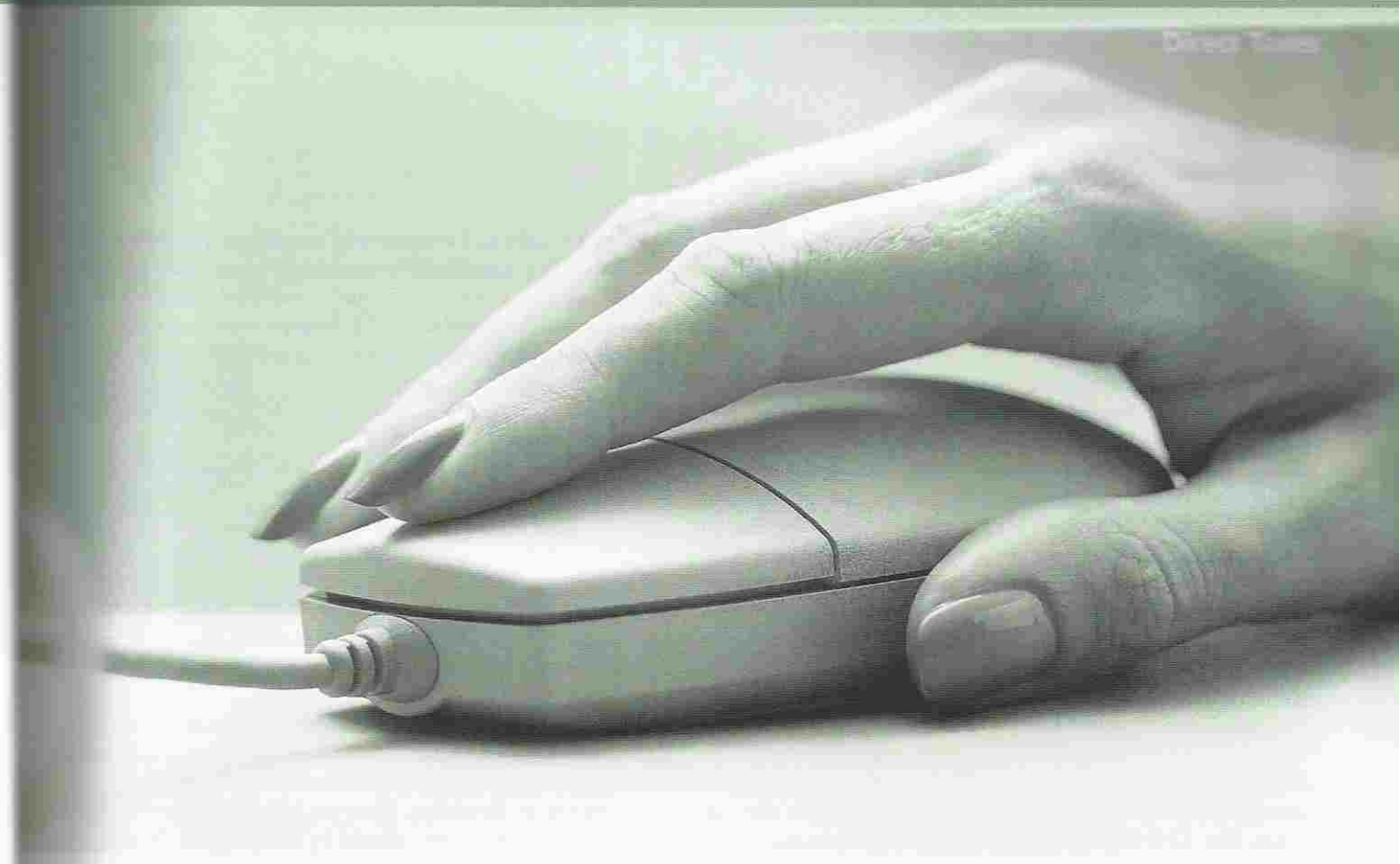
In Hong Kong, a survey was conducted to study the potential international problems created by e-commerce. The study found that e-commerce is posing problems for the income tax authority. The study also revealed that tax avoidance is the highest-ranking potential tax problem identified (Davis & Chan, 2000). Other problems identified were double taxation and tax administration, whilst tax evasion was perceived to be the least potential problem.

A similar view was given by the tax experts such as Horn (2003) and Cockfield (1999). They believe that e-commerce would unquestionably 'stir' the laws of taxation. The existing tax rules governing transactions are for conventional commerce where the physical presence can be easily identified. However, the same rules may not be suitably applied on e-commerce transactions. For example, the rule on permanent establishment (PE), which has been used as demarcation point to establish whether a source country should tax the profits derived from foreign businesses, is based on the principle of physical presence.

According to Borkowski (2002), apart from the issues of jurisdictions, PE, double taxation and source-based nature of tax principles, e-commerce also affects transfer pricing and intangible distinction issues (such as classification of business profits or royalties). These issues could lead to tax avoidance, double taxation and moving operations to a tax haven country.

Tax Issues

The major problem posed by e-commerce is fixing the place of transaction. The place where a web server is located, the place where a user initialises the transaction, and the server where



payment is collected, may be different (Vohra, 2004). Based on the traditional tax administration in most countries worldwide, income is taxed based on the territorial concept in which the location of the taxpayer will be the basis used to charge the income or profits. Normally, income is charged based on the scope of tax categories, such as territorial or derived, world income scope, or derived and remittance basis. Countries such as the United States of America, United Kingdom and Japan practice the world income scope while Malaysia and Singapore use the derived and remittance income scope. Hong Kong, African Countries and Middle East countries such as Jordan, however, favour the territorial or derived scope of charging income.

In situations of tax disputes between countries, tax treaties would be the solution to resolve the problems. Normally, PE would be used as a criteria to justify the status of the taxpayer. As PE means 'a fixed place of business', therefore, the legal authority to charge the income of the taxpayer would be the place where the physical presence of the taxpayer is identified. In the absence of PE, the country where goods or services are sold has no jurisdiction to tax the resulting income (Li & See, 2002). However, in the case of e-commerce, the determination of PE would be a problem. What used to be the traditional ways of taxing income, i.e., using physical location concept, now seems to play a minor role in solving disputes over the right to impose tax.

A study by Othman, Hanefah, and Bidin (2004) indicates that 90% of the respondents agreed that the present definition of PE does affect the concept of income in e-commerce trading. The results indicate that the respondents perceived the present definition of PE, if used in e-commerce environment, would result in tax loss, double taxation, and tax evasion. This is because they believed e-commerce would undermine the principles used to determine PE and would then create opportunities for tax avoidance and evasion.

Apart from that, e-commerce also posed tax administration problems to many tax authorities (Horn, 2003). This is mainly because the present tax rules have been designed to suit the traditional business models but not e-commerce. Furthermore, the sales and use tax issues are also points of concern with regards to e-commerce (Horn, 2003). This new wave of conducting business has created an intangible property and unidentified nexus that create difficulties in charging taxes.

Malaysian E-Commerce Taxation

In Malaysia, the traditional laws still govern e-commerce in which the scope of charge of income is based on the source and resident approach. According to the source based system practice in Malaysia, income is taxable if it is derived in Malaysia or received in Malaysia from abroad. Based on the source of income principle, the place where the contract is negotiated, the place where the contract is completed, and the place of business operation are the determining factors for taxing income. In brief this principle of using sources as a rule to tax income is centered on the physical locations. This concept, according to many researchers (Kasipillai, et al., 2002; Bruggen, 2002; Hong, 2002), would affect tax collection. Malaysia has yet to introduce any guidelines on e-commerce taxation. Judging from the taxation system point of view, it is crucial for Malaysia to identify potential problems and threats created by e-commerce. Otherwise, this could lead to potential loss in tax revenue.

Development in Other Countries

Many countries are more concerned about the impact of e-commerce on tax administration. However, only a few developed countries have taken steps to study and re-examine their present tax system. For example, the United States of

America passed the *Internet Tax Freedom Act in 1998*. This Act states that the government will not impose tax charges on Internet business for a certain period of time. At the state government level, the authority is restricted to charge multiple taxes on Internet trading.

Similarly, in 1999, Hong Kong Society of Accountants (HKSA) suggested that the tax authority should establish a Tax System Review Committee to examine matters related to the tax system. One of the issues raised by HKSA is how e-commerce transactions should be taxed. HKSA debated that e-commerce would pose problems on how to establish PE. It also questioned the strength and coverage of the existing tax legislation to bring the electronic based revenue to a tax network with a purpose to avoid loss of tax revenues (Cheung, 2001). In conclusion, it was suggested (Cheung, 2001) that Hong Kong would need new tax rules to avoid tax disputes and tax loss due to the development in e-commerce.

The Australian Taxation Office (ATO), on the one hand, has released a report on e-commerce and its impact on the tax system. The ATO Report concluded that the present tax system is designed for an environment without e-commerce (Davis and Chan, 2000). Whereas in India, some of the experts (based on the committee consisting of senior Indian government and industry officials) viewed that the present tax rule, which rely on the source is not suitable to be used as a basis to tax e-commerce business (Moran and Kumer, 2003). They believe the present basis would result in tax evasion and has taken a step forward to modify the PE concept.

Due to the disadvantages of having limited natural resources, the Singapore Government has taken full advantage of the knowledge-based economy to compete in the international market. Realising the importance of being in the circle of information age society, the Singapore Government has taken an active role in promoting e-commerce infrastructure. For example, the Singapore Government has launched the E-Commerce Hotbed (ECH) program which provides web site hosting information on e-commerce and the E-Commerce Master Plan to drive the pervasive use of e-commerce and to strengthen Singapore's position as an international e-commerce hub (Chan & Hawamdeh, 2002).

The Singapore Government's initiatives in establishing e-commerce economy have motivated many companies in Singapore to deploy the e-commerce platform introduced by the government for their online businesses. In a survey 'ICT adoption by businesses in Singapore', the results indicate that 80 percent of the organisations surveyed have access to the web and 50 percent are implementing e-commerce earnings. Through many e-commerce infrastructure plans and the positive response from the citizens, Singapore would be able to achieve its vision of becoming the major e-commerce hub in the region (Foley & Fang Khoo, 2000).

In February 2001, Singapore's Inland Revenue Authority issued a guideline on *E-Commerce Tax*. The guideline is known as Income Tax Guide on E-Commerce (2001). This guideline was published to educate companies on income tax treatment on e-commerce. It is a guide to be used in solving various situations where income from e-commerce transactions sourced in Singapore will be taxed using the Singapore current income tax law and principles. The guideline introduced situations such as

a) a company with business operations in Singapore, which has set up a website in Singapore,
b) a company with business operations in Singapore, which has set up a website in a foreign country,
c) a company with business operations in Singapore, which has set up a website and branch in a foreign country,
d) a company with business operations outside Singapore which has set up a website in Singapore, and
e) a company with business operations outside Singapore, which has set up a website and branch in Singapore.

The guideline also explains and tackles the issue as to how PE is established in an e-commerce environment. It specifically states that the mere presence of a physical server in Singapore will not mean trading in Singapore. However, significant questions still remain as to how income should be classified for Singapore's income tax purposes.

Organisation for Economic Co-operation and Development (OECD) Initiatives

The OECD has taken many initiatives to highlight the significance of e-commerce through discussions and conferences. The OECD Model Tax Convention is considered to be the benchmark for taxing e-commerce and it has been adopted by many countries worldwide (Scally, 2002). The organisation focused on three main areas most affected by e-commerce, namely international direct tax, consumption tax, and the application of PE to e-commerce (Moran and Kummer, 2003). The OECD Electronic Commerce and Taxation Conference held in October 1998 has reached a consensus relating to various issues concerning e-commerce and resulted in a joint declaration on taxation and e-commerce. In addition, the Ottawa Conference concluded that government and companies must cooperate to implement a taxation framework for e-commerce in order to realise the full potential of new technologies. The conference representatives considered new technologies have a great potential to simplify tax systems and enhance taxpayer services using the same principles that are adopted in the current tax system. Sequentially, in October 1999, the OECD Working Group on Tax Conventions proposed the application of PE definition for e-commerce transactions, as many countries have adopted the definition as a guide to address the issues on PE in their respective jurisdictions.

The OECD later updated the guideline with regards to PE where issues pertaining to e-commerce are discussed. The update has identified 28 different transactions and related payments involving varying degrees of e-commerce (Scally, 2002). However, the commentary, in particular, on Article 5 (on PE) of the guideline is narrow because it is confined to the consideration of the present definition of PE without discussing

the broader and important issues such as proposed changes that should be made to the definition or whether the concept should be abandoned.

CONCLUSION

E-commerce will be the new way of doing business. It is taking the business world to a new paradigm shift. It poses a number of problems and challenges not only to companies but also to tax authorities. These challenges can be overcome if concerted efforts are made by the tax authorities to study the problems and take steps early so that tax revenue will not be eroded.

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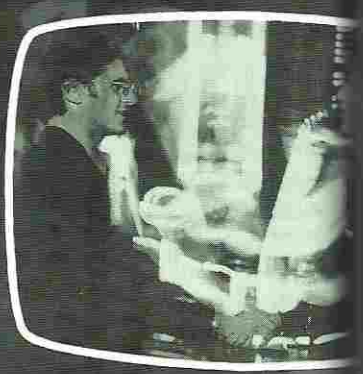
Trading with and Trading with Malaysia

BY SIVA NAIR



In any discussion on the taxability of income one has to have a firm understanding of the scope of charge. Students will remember that sec. 3 of the *Income Tax Act 1967* (as amended) provides that all income accrued and derived in Malaysia will be taxable and foreign income received in Malaysia is also taxable. However, foreign income received in Malaysia is exempt under paragraph 28 of Schedule 6 unless the recipient is a resident company involved in the business of insurance, banking or sea and air transport.

Therefore, Malaysia derived income is taxable for everyone unless specifically exempted under the *Income Tax Act 1967*. The question is, when is a person considered to be trading within Malaysia whereby the income derived therefrom is regarded to be Malaysian income as opposed to trading with Malaysia whereby the income is NOT derived from Malaysia?

WHAT IS TRADING WITH & TRADING WITHIN MALAYSIA?

The question you need to ask is do you have a business presence in Malaysia. Where the person dealing from outside Malaysia does not have a business presence in Malaysia than the person is regarded to be trading with Malaysia (see Figure 1). Consequently, all income derived from that transaction would be considered to be income derived in the United Kingdom and not Malaysia. In the event the person has a business presence in Malaysia, he is regarded to be trading within Malaysia (see Figure 2), and all income derived from that transaction would be considered as Malaysia income.

Figure 1

Figure 2

Of course, where business activities are wholly or partly carried on in Malaysia, i.e. the person is here in Malaysia and conducting the business through a branch or company, then obviously, he is trading in Malaysia. However, what if he only has a representative office here or only has an agent here?

To answer this, the following factors should be considered.

Is Capital Employed In Malaysia?

This would encompass expenditure incurred on the acquisition of a building to be used as a factory, office or warehouse or the purchase and maintenance of fixed assets used in the business etc., which would be indicative of a business presence in Malaysia.

Are Contracts Concluded In Malaysia?

Does the representative or agent in Malaysia possess the power to conclude contracts? For example, if the agent is able to provide you with all the necessary information regarding the product but is not legally authorised to sign the contract for sale, then there is no business presence in Malaysia. However, where the agent contracts on behalf of (and legally binds) the foreigner (principal), then the foreigner is considered to have a business presence in Malaysia.

Are Stocks Maintained In Malaysia For Fulfillment Of Orders?

Does the representative or agent keep stocks of the products here in Malaysia such that once a customer has decided to buy the product, he can actually deliver immediately? An affirmative answer would sway the conclusion drawing process towards having a business presence in Malaysia as opposed to the agent having to order the goods from the principal.

Does Title To the Goods Pass In Malaysia?

The point of crystallisation of the sale generally culminates with the legal transfer of the ownership of the goods. Therefore, if the actual sale (or transfer of legal title) occurs in Malaysia between the agent and the customer, then agent will be deemed to be the "business presence" of the foreigner in Malaysia.

Are Proceeds of Sales Received In and Payment of Related Expenses Made From Malaysia?

Where accounts are maintained in Malaysia relating to income from sales and the related expenditure incurred, it would be suggestive of a business presence in Malaysia.

Individually, none of the factors are conclusive but they are persuasive in determining whether a person has a business presence in Malaysia. The existence of these factors should be analysed in view of the surrounding circumstances. For example, more than just looking at where the contract is made, one should also determine where the contract is being carried out i.e. where the sale transpires and the legal title for the goods pass.

As Atkin L.J. said in GREENWOOD v F.L. SMIDTH AND CO. [(1921) 3 KB

'I can imagine cases where the contract of resale is made abroad and yet the manufacture of the goods, some negotiations of the terms and complete execution of the contract take place here under such circumstances that the trade was in truth exercised here. I think that the question is, where do the operations take place from which the profits in substance arise?'

However, if one establishes that the activities in Malaysia were not substantially connected or concerned with the earnings of profits, then the person may be relieved of exposure to Malaysian tax.

Permanent Establishment

This is a concept referred to in Double Taxation (Relief) Agreement to indicate whether a foreign enterprise has a business presence in Malaysia. (As one of the objectives, a Double Taxation (Relief) Agreement has provided a clause on the avoidance of double taxation where two countries concurrently impose taxes on the same income. A detailed study of the agreement will be undertaken in a later article.)

Definition

The definition of a permanent establishment is more or less standard in most Double Taxation (Relief) Agreement. However, there may be some variations in the Double Taxation (Relief) Agreements signed by Malaysia. The variation will not be discussed in this article.

In discussing the concept of permanent establishment lets look at a past year question.

MIT TAX V DEC 2003 Q5

Compuserve Pte Ltd (CPL) is principally engaged in the sale of computers in Australia. CPL has decided to expand sale of their products to Malaysia. A Double Taxation Agreement exists between Malaysia and Australia. The income derived from the sale of computers will be regarded as carrying on business in Malaysia if CPL is carrying on a trading activity through a permanent establishment in Malaysia.

I will be using this question throughout the article so don't forget the facts of the question!!

Required:
(i) Briefly, what is a permanent establishment?
(ii) What is the significance of a permanent establishment?

Let's look at part (ii) first. The significance of determining whether a person has a permanent establishment is that gains or profits from a business of a foreign enterprise are taxed in Malaysia only if the foreign enterprise operates in Malaysia by way of a permanent establishment. Having identified the significance, let's look at part (i).

Generally, based on a Double Taxation (Relief) Agreement using the OECD model, Article IV defines a permanent establishment to mean a fixed place of business through which the business is carried out:

- a place of management
- branch
- office
- factory
- workshop
- mine, oil or gas well, quarry or other place of extraction of natural resources
- a building site or construction, installation or assembly project which exists for more than 6 months
- farm/plantation
- place of extraction of timber or forest produce

Deemed Permanent Establishment

The article also **deems** the following circumstances to be a permanent establishment where a person from one country:

- carries on supervisory activities in the other country for more than 6 months in connection with a construction, installation or assembly project which is being undertaken in that other country
- carries on a business which consists of providing the services of public entertainers in that other country

Further Concept of Permanent Establishment

- The article introduces a further concept of permanent establishment to cover circumstances where a person from one country say Mr. Y, (although not present in the other country), has another person (Agent X) acting on his behalf in that country, and he (Agent X), habitually exercises in that country, an authority to conclude contracts in the name of Mr. Y, unless "Agent X's" activities are limited to the purchase of goods or merchandise for the enterprise, **OR**

- Agent X maintains in that country a stock of goods or merchandise belonging to Mr. Y from which he regularly fills orders on his behalf

Excluded from the concept of a Permanent Establishment

However, certain activities undertaken by an agent or representative of a person from one country, in the other country, would **NOT** be regarded as the principal having a permanent establishment in the other country. Remember the MIT question earlier whereby Part (iv) requires

'State briefly any three (3) business activities that CPL could undertake in Malaysia without creating a permanent establishment in Malaysia.'

These include:

- use of facilities in the other country solely for the purpose of storage, display or delivery of goods and merchandise belonging to the principal;
- maintenance of a stock of goods or merchandise in the other country belonging to the principal solely for the purpose of storage, display or deliver;
- maintenance of a stock of goods or merchandise in the other country belonging to the principal solely for the purpose of processing by another enterprise;
- maintenance of a fixed place of business in the other country solely for the purpose of purchasing goods or merchandise or for collecting information for the principal; and
- maintenance of a fixed place of business in the other country solely for the purpose of advertising, for the supply of information, for scientific research or for similar activities which have as preparatory or auxiliary character for the principal.

Is a Subsidiary the Permanent Establishment of a Parent Company?

Generally, the Article provides that a subsidiary does not constitute a permanent establishment of the holding company nor vice versa. The standard wording in paragraph 7 of Article IV is

'The fact that a company which is a resident of one of the Contracting States controls or is controlled by a company which is a resident of the other Contracting State or which carries on business of the other Contracting State (whether through a permanent establishment or otherwise) shall not of itself onstitute either company a permanent establishment of the other.'

Students will remember from their law paper that a company is treated as a separate legal person from its shareholders and therefore, a subsidiary and its parent company are legally two different persons.

Example 1

Germaine Pte. Ltd., a company resident in the England has a subsidiary in Malaysia Gemanis Sdn.Bhd., a Malaysia resident company. Neither company represents a permanent establishment of the other in the other country. Therefore, business profits of Germaine Pte. Ltd derived from Malaysia cannot be taxed in Malaysia merely because Gemanis S/B is in Malaysia.

However, where the subsidiary company acted as an agent for the parent company in circumstances pointing to a trading of the parent company in the host country using the subsidiary as an agent, then the subsidiary company can be considered as a permanent establishment. This is illustrated in the following case.

FIRESTONE TYRE & RUBBER CO. LTD. v LEWELL IN (H.M. INSPECTOR OF TAXES) 37 T.C. III.

FACTS OF THE CASE

The holding company (HC) had a world wide organisation for the sale of Firestone tyres. The tyres were manufactured and sold in the United Kingdom by its subsidiary company (SC). The distributors of HC were given a list of manufacturers including SC from whom they could procure the tyres. There was also an agreement between HC and SC, for the latter to fulfill orders received by the former from abroad.

DECISION OF THE COURT

The House of Lords held that HC exercised a trade of selling tyres through the agency of its subsidiary company SC.

However, a mere use by a parent company of its subsidiary company's space and employees would not constitute a permanent establishment as seen in the following case.

TARA EXPLORATION & DEVELOPMENT CO. LTD. v M.N.R. 24 D.T.C. 6370.

FACTS OF THE CASE

The holding company, resident in Ireland used the space and the services of the employees of a related company in Ontario (Canada). The holding company also maintained a bank account in Ontario for the purposes receipts and payments.

DECISION OF THE COURT

The judge held that the holding company had a "permanent arrangement" with the related company but had no "permanent establishment" because a permanent establishment required "persons with authority to carry on some part of the taxpayer's money making activities" i.e. the related company was not an agency of the parent company through which the parent company traded in Canada.

Is an Agency a Permanent Establishment

Going back to the MIT question earlier. Part (iii) requires

'CPL proposed to appoint agents in Malaysia to distribute computers to the Malaysian customers Briefly, describe the circumstances under which the appointment of agents in Malaysia would create a permanent establishment for CPL in Malaysia.'

As we have seen earlier a permanent establishment will exist if the agent habitually exercises in that country, an authority to conclude contracts in the name of the principal and maintains in that country a stock of goods or merchandise belonging to principal from which he regularly fills orders on his behalf.

However, trading with Malaysia through a broker, general commission agent or any other agent of an independent status,

acting in the ordinary course of business would not constitute a permanent establishment i.e. if the agent is trading on his own behalf, then there is no case for finding that a foreign enterprise (with whom the agent has trade dealings) is trading in Malaysia through a permanent establishment.

The same concept will apply i.e. if they maintain a stock of goods for fulfillment of orders and have the power to conclude contracts, then the answer is in the affirmative.

What about Sales Representatives?

However, if they are solely here for the purposes of advertisement or collection of information; there is no permanent establishment as shown in the following case.

RONSON ART METAL WORKS (CANADA) LIMITED v MINISTER OF NATIONAL REVENUE 10 D.T.C. 440

FACTS OF THE CASE

The company based in Toronto was involved in the manufacture and retail of lighters and other accessories. It sold its products directly to distributors and retail chain stores. In Quebec, instead of a branch office, it had a local sales representative whom the clients were supposed to contact at home. His task was to prepare orders and dispatch them to his headquarters which subsequently would be channeled to the various distributors. The sales representative had

- no office (clients contacted him at home),
- no stock on hand, and
- no authority to contract for his employer.

DECISION OF THE COURT

It was held that there was no permanent establishment because the sales representative was not holding a stock of merchandise from which he could regularly fill orders and had no power to conclude contracts.

Students can grasp a clear picture of the status of sales representatives by juxtaposing the previous case with the following one, also a Canadian case.

PANTHER OIL & GREASE MANUFACTURING COMPANY OF CANADA v. MINISTER OF NATIONAL REVENUE 11 D.T.C. 494

FACTS OF THE CASE

The company's manufacturing plant was at Ontario and it supplied products to the extensive sales organisation that the company maintained in Quebec which consisted of a provisional manager, a number of district managers and about 150 salesmen. The provisional manager and most of the district managers maintained offices in their homes and kept on hand a substantial quantity of the

company's products for immediate delivery to customers. The salesmen had full authority to accept orders from new customers.

DECISION OF THE COURT

The judge, in confirming that at there was a permanent establishment, opined:

"All that is called for is an office in which its business is done. The evidence show that such offices were maintained by the division manager and a number of the district managers. Moreover, substantial quantities of the appellant's goods were kept thereat. That such offices were maintained in private residences, should not affect the matter.

Would the existence of substantial equipment constitute Permanent Establishment

Under some of the Double Taxation (Relief) Agreements signed by Malaysia, the concept of permanent establishment includes substantial equipment being used or installed by, for or under a contract with the foreign enterprise, in the other state.
Based on decisions in some cases, the following propositions can be made:

- substantial equipment does not necessarily mean a large quantity of equipment; even a single piece of heavy machinery will do
- equipment used for demonstrations or advertisements are excluded
- the mere presence of the equipment would not constitute a permanent establishment; it must be used or installed by, for or under a contract with the foreign enterprise

Example 2

TeleBuild Sdn Bhd brings in the latest state of art telecommunication equipment from a company in Sydney for exhibition and demonstration purposes at the International Telecommunication Fair held at PWTC.

Solution:

The company in Sydney would not be deemed to have a permanent establishment in Malaysia because the equipment is not used or installed by, for or under a contract with the foreign enterprise.

Example 3

TeleBuild Sdn Bhd enters into an agreement with the company in Sydney to form a consortium. They have been awarded a contract by a major telecommunication company in Malaysia for the installation and commission of a telecommunication network in Malaysia, which requires substantial equipment to be brought into Malaysia by the Sydney Company. However, the Sydney Company will not have an office in Malaysia nor will any staff be sent to Malaysia.

Solution:

The Sydney Company would be deemed to have a permanent establishment in Malaysia, although they have no office or staff here, because substantial equipment is used under the contract for the installation and commission of the telecommunication network in Malaysia.

CONCLUSION

The above discussion basically throws some light as when a person is trading with Malaysia and when it is trading within Malaysia and in case where there is a Double Taxation (Relief) Agreement signed by Malaysia, whether a permanent establishment is existence in Malaysia. In the next article we will discuss further on these issues.

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What is GST to the Man in the Street?

BY CHAN KEE HOONG

THIS ARTICLE IS CONTRIBUTED BY BDO BINDER TAX SERVICES

A new tax called the Goods and Services Tax (GST) has been proposed by the Malaysian Government to be implemented on 1st January 2007. This new tax will replace the existing sales tax and service tax.

What would be the possible implications of this new tax for the man in the street?
Will this tax affects all goods and services?
Is everyone liable to GST?
Will it bring an increase in the prices of goods and services in the country?

This article takes you through an array of questions that would arise on one's mind and the answers are provided with simple examples, diagrams and tables that are easy to understand.

What is GST

The GST is a tax on domestic consumption. The tax is paid when money is spent on goods and services, including imports. In general, goods sold or services performed in Malaysia are taxable. There are however possible exceptions such as consumer banking services which will be exempted.

The GST charged to customers is called output tax and that paid on business purchases is called input tax.

Will the GST affects all goods and services?

Practically all types of goods and services will be subject to GST with the exception of certain essential goods such as vegetables, meat, rice, chicken, beef and fish and certain services such as healthcare, education, saving and current accounts, ATM cards and life insurance. The goods and services concerned will be standard rated.

Who is liable to Tax? Will it include everyone?

Any person including sole proprietors, partnerships, a corporate body, club, association, society, management corporation or organisation who supplies taxable goods and services in the course of business, subject to a threshold which has yet to be determined by the government, will be liable to pay this tax. However, small businesses will most probably be exempted from GST.

What happens to the Current Sales Tax and Service Tax?

The current sales tax and service tax will be abolished by 2007. All persons who are at present licensed under the *Sales Tax Act 1972* and *Service Tax Act 1975* will need to register for GST. The registration process is scheduled to start in July 2006.

What does it mean to the ordinary man in the street?

GST will affect practically all aspects of his lifestyle. If he goes to a medium sized restaurant, all food and drinks including cigarettes etc. will be subject to GST. When a person checks into a hotel, there will be no more government tax of 5% but a GST rate.

Purchases from supermarkets and hypermarkets will be subject to GST. Petrol stations, toll gates, parking lots, will all charge GST and the final consumer is the one who absorbs it all.

Let's take a look at Illustration 1 below to understand the effect of GST.

Illustration 1-A man buys a VCD player from an electrical shop

GST PROCESS

Business Entity	Sales Price (RM)	Tax on Output (RM)	Tax on Input (RM)	Net Tax Paid (RM)
Raw Material Supplier	10.00	0.50	0	0.50
Manufacturer	50.00	2.50	0.50	2.00
Whosaler	70.00	3.50	2.50	1.00
Retailer	100.00	5.00	3.50	1.50
Total GST collected by the Government				5.00

Note: Assumption - GST rate is 5%

Final amount that a consumer has to pay for his VCD player is RM105.00 (Selling Price + GST)

But there will be a number of outlets which will not charge GST. For example, anyone who walks into a small coffee shop to have a drink or buys a burger from a burger stall will not have to pay GST as these outlets will probably have a sales turnover which is below the prescribed threshold. Similarly, patients seeking medical treatment in clinics and hospitals will not be charged GST.

Most small businesses will operate below the threshold and will not charge GST. This may be quite similar to the current service tax which is not imposed for example on hotels having less than 25 rooms, restaurants having a sales turnover below RM500,000 and so on. In addition, a number of services which are considered to be essential will be exempted from GST.

How does one register and who is authorized to charge GST?

Any person who is required to be registered needs to do so with the Royal Malaysian Customs Department. Registration can be done online or manually. A person who is not required to register can opt for voluntary registration and claim input tax credit on his purchases. Once the relevant legislations are passed, the Customs Department will most probably educate the public on the process of registration.

Any person registered under the Goods and Services Tax Act will most probably be given a certificate and a registration number. This person will be required to issue a tax invoice each time he makes a supply of goods or services. The tax invoice should have the GST registration number listed on it.

What happens to the GST collected?

Any GST registered person who collects the GST has to remit it to the Customs Department on periodic basis. The GST

collected is to be declared on a GST return which can be submitted either online or manually.

How is GST levied on imported goods and services?

For imported goods, GST will be levied together with the import duty and excise duty, if any, by declaring on the Import Declaration Form and is payable at the time the goods are cleared from Customs control. The value of the imports should be in Malaysian Ringgit. However, if the import is in a foreign currency, the rate to be used will be determined by the Customs Department. In addition, a number of imported goods which are listed under the Import Relief Order are to be exempted from GST.

For imported services, the reverse charge mechanism will apply. When a person receives services from abroad, the services will be treated as if such person had made the supply and the supply was made to him. GST will be payable on the value of the services provided.

What about exported goods and services?

All goods exported out of Malaysia will be zero-rated. This means that the registered exporter does not collect GST on his exports but is able to claim credit for the GST that he has paid on his inputs. However, the exporter must retain supporting documents such as the Export Declaration Forms and copies of his invoices issued as evidence of export.
Exported services, for example

i. services wholly performed out of the country,
ii. services supplied directly in connection with land or any improvements to land thereto situated outside Malaysia,
iii. services relating to the export of goods and so on will be zero rated.

Will there be a rise in the prices of goods and services?

It would appear that a slight increase in the prices of goods and services may take place. It must be borne in mind that the current sales tax of 5% and 10% and the service tax of 5% will be replaced by the GST which will probably be 5% or below. However, the scope of goods and services affected by GST will be very much wider. No one knows exactly how much price increase there is going to be but what is worrying is that unscrupulous traders might take advantage of the GST to unnecessarily increase prices and pass this down to the final consumer.

How will it affect a supplier, manufacturer, wholesaler and retailer?

A supplier, manufacturer, wholesaler or retailer would have to pay for GST on his business purchases which are standard rated before selling his product.

This means that he may have to carefully plan his cash flow and turn around time to cope with his business activity. Improper planning may lead to a huge cash flow deficit as it may take a few months before his product can be sold to the consumer.

Lets go back to Illustration 1 to see this impact.

GST is imposed on every stage of input, until the final good is sold to the customer, as shown below:

RM 0.50	as a raw material supplier
RM 2.00	as a manufacturer
RM 1.00	as a wholesaler
RM 1.50	as a retailer
RM5.00	Total GST paid for the good

Taking the above example, if the manufacturer produces 10,000 units per month, his cash flow outlay to pay the input GST would be RM5,000 per month (RM0.50 X 10,000 units).

For the wholesaler, his cash flow outlay to pay input GST would be RM25,000 per month(RM2.50 X 10,000 units).

For the retailer, his cash flow outlay to pay input GST would be RM35,000 per month(RM3.50 X 10,000 units)

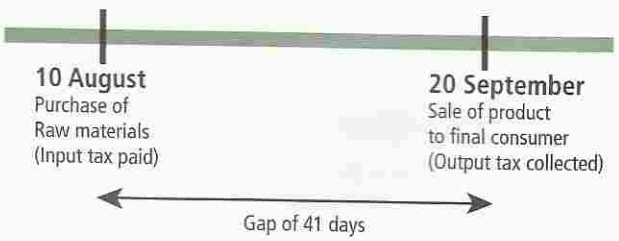
Based on the above simplistic example without taking the claim for a credit for input tax at each level of the supply chain, one could see the possible cash flow implications under the coming GST environment.

In this light, the respective parties may need to carefully plan and prepare themselves for the implementation of the GST to avoid possible cash flow deficits and to maintain liquidity in spite of a claim for a credit at each level of the supply.

The possible impact of cash flow on manufacturers, wholesalers and retailers.

Further to the above, Illustration 2 indicates the time gap that a manufacturer needs when he buys the raw materials in 10 August to the time when he finally sells the product to the final consumer, after the stages of value add, in 20 September. From the example, we can see that the manufacturer will require at least 41 days before he can recover the GST paid from the consumer with his profit.

Ilustration 2
The gap between the purchase of raw materials and the sale of the final product



I understand that a GST registered person can claim input tax credit. How is this done?

The GST registered person who is actually the supplier of goods or services is eligible to claim input tax credits for any GST paid in the course of making the supply. The net amount to be paid to the Customs is the difference between the input tax and the output tax. If the amount is positive then that amount is payable to Customs. If it is negative, then a refund can be claimed. The reason for this is that GST being a value added tax is only payable on the portion of the value added to the good or service. Let's take a look at the example below where he is a supplier, manufacturer, wholesaler and retailer:

Illustration 1A - GST assumed at 5% is imposed on every stage of input, until the goods are sold to the customer, as shown below:

Business Entity	Sales Price (RM)	Tax on Output (RM)	Tax on Input (RM)	Net Tax Payable to Government (RM)
Raw Material Supplier	10.00	0.50	0	0.50
Manufacturer	50.00	2.50	0.50	2.00
Whosaler	70.00	3.50	2.50	1.00
Retailer	100.00	5.00	3.50	1.50
Total GST collected by the Government				5.00

Note: Input tax is claimed at each stage

However, even with the claim of tax credits, the man-in-the-street as a supplier must consider carefully his cash flow needs to avoid any deficits during the course of his business as part of the supply chain.

Will I have to pay more taxes now?

With the implementation of the GST regime and the possible inflationary price hikes, the major question in our minds would be, will there be some form of direct tax cuts or exemptions for individuals and businesses?

If we are to take Singapore as an example when they introduced GST into their economy, it is hoped that the Malaysian Government will consider a reduction in personal and corporate income taxes so as to alleviate the financial burden on individuals and at the same time help to reduce the cost of doing businesses.

How do I prepare for GST?

As the man-in-the-street, apart from savings on a possible reduction in income tax rates, he may also need to adjust his lifestyle taking into account of the impact of GST on the goods and services he consumes. As a businessman, he needs to consider questions like when he should begin, where he should start and how he should carry out the preparation for a smooth GST implementation and compliance. He may wish to seek professional assistance to review his current system to identify his business set–up and supply chain and to change or modify the system to be GST compliant by end 2006 without disruption to his day to day business activities.

CONCLUSION

GST is a broad-based consumption tax and it will affect most goods and services. It appears that the introduction of GST could lead to inflationary pressures for taxpayers if it is not implemented properly. At present, there are uncertainties over this new tax to be imposed. Clear rules and regulations needs to be wisely formulated. This is the time where proper guidance and early planning shall be required to prepare the taxpayers for the smooth implementation.

Meanwhile, the GST legislation is expected to be passed sometime in March or April 2006. In addition, in the next few months, the Royal Malaysian Customs Department should be finalising the GST rate and the threshold for businesses.

It is hoped that the Malaysian Government will start off with a low GST rate to reduce the financial burden for the man-in-the-street and to gradually increase it through the years. With a broader base for goods and services being subject to GST, the revenue for the Government is expected to be higher.

In conclusion, the GST being a consumption tax is likely to have an inflationary effect on taxpayers but as consumers, they have a choice to a certain extent whether to pay the tax should they decide to consume any of the non-essential goods and services.

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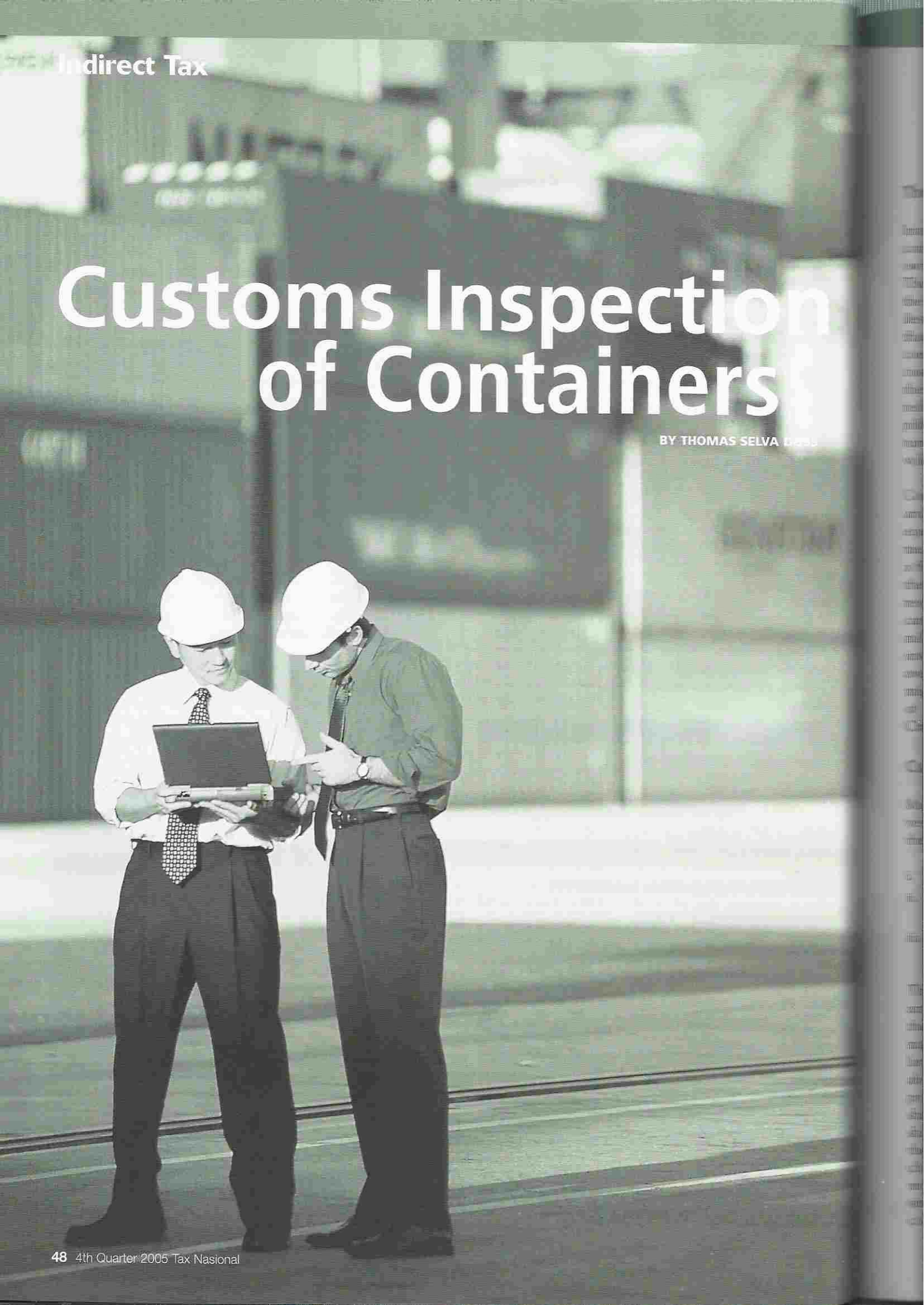
Customs Inspection of Containers

BY THOMAS SELVA DASS



The use of containers

International shipments of cargo often involve the use of containers. The shipper in one country places cargo into an owned or leased container at its facility or at point of origin. Then the container is transported via rail or motor carriage to the port for loading onto a container ship. After arrival at the destination port, it is unloaded and mounted on to a trailer in that country and subsequently delivered to the customer or consignee. The shipment leaves the shipper and arrives at the customer's location with minimal handling of the items within the container. The use of containers in intermodal logistics reduces staffing needs, minimizes in-transit damage and pilferage, shortens time in transit because of reduced port turnaround time, and allows the shipper to take advantage of volume shipping rates.

Containers come in three common standard lengths of 20ft, 40ft and 45ft. Container capacity is measured in twenty-foot equivalent units (TEU). A twenty-foot equivalent unit is a measure of containerized cargo equal to one standard 20ft x 8ft x 8.5ft. (approximately 40.92 m3). Most containers today are of the 40ft variety and thus are 2 TEU. Containerization has revolutionized cargo shipping. Today, approximately 90% of cargo moves by containers stacked on transport ships. Over 200 million containers per year are now moved between international ports and the traffic is estimated to grow at an average rate of 5 per cent per annum over the next 10 years. It might even double by 2010 due to a large extent by the growth of many Asian countries, most notable among them being China, Japan, Korea and even Malaysia.

Customs Requirements for Arriving Vessels

Malaysian customs regulations dictate that the master of every vessel arriving at any customs port shall either personally or through his agent :

i. report to the customs of the arrival of such vessel;
ii. provide information relating to the vessel, cargo, crew and voyage; and
iii. if requested by the customs, produce the port clearance granted at the last port of call.

The master is also required, within twenty-four hours after arrival of the vessel and before any cargo is unshipped to present the inward manifest to the customs containing particulars as to marks, numbers and contents of each package intended to be landed at the port. If there are any goods for transshipment aboard the vessel a transshipment manifest is also to be provided. The manifest is considered to be an important shipping document especially when the vessel has multiple shipments or stops. This document, used in combination with the bill of lading, lists transit stops, consignees, and product characteristics. In essence, the shipping manifest summarizes the multiple shipments that are being transported by the vessel in a single move. After compliance with customs requirements, the containers are then unloaded and transported to the container yard of the port. This is a bonded and restricted area. Port regulations allow free storage period of five days for containers. During the period, the customs, health and veterinary officers will conduct their inspections. Containers can also be moved to inland ports such as the Inland Clearance Depots at Prai, K.L. (Jln Klang Lama), Petaling Jaya, Nilai Inland Port, Segamat Inland Port and the Ipoh Cargo Terminal.

Customs Importation Procedures

Sec. 78(1) of the *Customs Act 1967*, requires every importer of dutiable goods, before removal of the goods from the bonded area to make a declaration in the form Customs No.1, and pay the relevant customs duty, sales tax, excise duty or other charges payable within 14 days of such declaration. The declaration should provide a full and true account of the number and description of packages, weight, measure or quantity, the value of such goods and their country of origin.

Importers normally engage the services of a forwarding agent who is registered with the customs to clear goods from customs control. The agent is authorized to transact business at any customs office on behalf of such person or firm. Once the goods are declared in the Customs No.1 form, it is left to the senior officer of customs on duty to exercise his discretion whether to inspect the contents of the container or to authorize release of the container straight away. If he chooses to inspect the contents of the container, he will then indicate so in the Customs No.1 form. The customs officer on duty at the container yard will then carry out the inspection and endorse his findings on the Customs No.1 form. Electronic Data Interchange (EDI) procedures currently greatly facilitate clearance procedures.

Due to the large volume of cargo movement, it is quite impossible for customs to inspect each and every container. In most cases, the senior officer of customs studies the description of goods declared on the Customs No. 1 form and if satisfied, authorizes release.

A few doubtful declarations are held back by the officer who will then order a scanning of the container. The decision to scan a container involves a risk management analysis based on the risk management procedures. This technique was created by the local customs officers who had considerable amount of experience at entry points. Currently two types of scanners are used by the Malaysian customs - the mobile scanner and the re-locatable scanner.

The VCIS2 scanning machines at Port Klang and Penang Port, Sabah and Sarawak use gamma radiation to penetrate the containers and display an image of the cargoes within. The gamma rays come from a small radioisotope pellet with an electronically controlled shutter opening the source enclosure. Gamma ray imaging technique requires a very low radiation dose rate. Therefore, it can be operated without special protective building or similar enclosure. The radiographic inspection of the container, including the analysis of the scanned image by trained image inspection officers, will take

approximately 5 to 10 minutes. If the image reveals that a further inspection is required, the container will be unstuffed for physical examination. The length of time required for this examination will vary according to the type of examination required.

The benefits of scanning are to:

i. Verify contents against customs documents;
ii. Combat trade in arms and explosives;
iii. Help in the international fight against terrorism;
iv. Reduce illegal immigration;
v. Detect high-tax goods like tobacco and alcohol;
vi. Prevent import, export and transit of protected plant and animal species; and
vii. Smoothen the progress of goods by reducing time spent on physical searching of containers.

Such scanning is fully in line with the recommendations of the World Customs Organization Kyoto Convention 1999, which stipulates that customs authorities should reduce their exclusive reliance on checking movements of goods, and focus more on selective audit controls, using risk management techniques.

Under certain conditions, X-ray scanning on arrival is the most efficient way available to control imported goods without unloading them. It is particularly useful to customs authorities in their continual efforts to prevent smuggling and other illicit activities.

Importation of Goods by Road

The movement of goods by road are also subject to the same procedures as goods imported by sea or air, only that they are declared to customs at the time the lorry or the trailer arrives at the checkpoint. Importation of goods from Thailand is only possible through the prescribed points of entry mainly, Padang Besar, Wang Kelian, Bukit Kayu Hitam, Pengkalan Hulu and Rantau Panjang. For example, trailers arriving at Bukit Kayu Hitam checkpoint have to be cleared beforehand at the Thai Sadao customs checkpoint where Thai customs officials inspect the container or cargo before giving it the green light to proceed to Bukit Kayu Hitam, only a few yards away. Once the vehicle enters Malaysian territory, Malaysian customs officials will take over. More often than not, the container or cargo will be released based on the information provided in the customs declaration form and when customs duties are paid. Seldom are the containers opened for inspection, unless specific information is received from an informer that the container contains contraband. In such a case, the trailer will be pulled aside for a 100% inspection by preventive officers and in the event of finding any contraband, the driver of the vehicle and the vehicle itself will be detained.

Peak Periods

The greatest challenge faced by customs and port authorities is during the festival periods where the volume of cargo increases considerably and a number of government officials are on leave. For example, North Port and West Port usually have contingency plans to ensure smooth operation of the cargo handling during the festive seasons such as Deepavali and Hari Raya holidays in November 2005. All key government agencies, terminal operators and haulier operators together with customs will operate 24 hours during the festive period to ensure port operations and the clearance of containers do not experience delays. Hauliers, warehouse operators and port users are required to stay open to allow the smooth movement of import and export boxes. The port operators being under essential services could not shut down completely to avoid any disruption to the country's supply chain. The logistics chain involves the interface of a number of players and every player has a role to play to ensure the link in the chain is not broken or weakened. Customs also has to operate with a skeleton staff as most officers will be on leave during the Hari Raya-Deepavali period. Quite a number of customs officials will be celebrating their Hari Raya at the ports and airports.

Wrongful Declaration of Goods

Many importers are in the habit of wrongfully declaring their goods with the intention of not having to apply for an approved permit or paying a lesser amount of import duty. Wrongfully declaring goods is an everyday affair, with most of the importers getting away with it. For example, an importer of pneumatic rubber tyres for buses and lorries with the tariff code of 4011.20.000 attracting an import duty of 40% and a sales tax of 10% may declare the same under the tariff code 4011.61.000 (tyres for agricultural or forestry vehicles) which attracts an import duty of 30% and no sales tax. It will be quite difficult for the customs officer on duty at that time to notice the difference. There may be only a small difference in the size of the tyres and an untrained eye often will not notice it. What is more common is that companies who import second hand automotive components and spare parts often declare them as scrap metal. Because these components are stained and covered with rust, most declarations of scrap metal are accepted and released by customs.

Goods can also be wrongfully declared without the intention to fraud. For example, an importer of mixed fruit juice which is classified under the tariff code 2009.90.910 and attracting an import duty of 10% and a sales tax of 5% could declare it as apple juice with the tariff code of 2009.71.910 attracting an import duty of 8% and a sales tax of 5%. In his opinion the content of apple juice as a portion of the total fruit juice could be higher and the texture of the contents appear to be apple juice in appearance. In cases such as these, the importer has most probably made a mistake and will be compounded.

Preventive Investigation

Goods which are wrongfully declared could be a subject for preventive investigation. Containers which are wrongfully declared especially with fraudulent intent are normally hauled to a preventive detention yard where they can be detained for weeks. Preventive officers would conduct a full inspection by removing each and every one of the packages to determine if they are wrongfully declared with the willful intent to evade customs duty. If the answer is yes, statements would be taken from the relevant parties with a view to prosecution. Investigations would be carried out and if necessary, the persons involved would be prosecuted.

Sec. 133(1) of the *Customs Act 1967* states that whoever makes, orally or in writing, or signs any declaration, certificate or other document required by this Act which is untrue or incorrect in any particular case shall on conviction be liable to a fine not exceeding five hundred thousand ringgit or to imprisonment for a term not exceeding five years or both. This is a compoundable offence and the senior officer of customs can offer a compound of up to five thousand ringgit.

Customs Golden Clients System

On the 8th September 2004, the Director-General of Customs launched the Customs Golden Client System which provides privileged clients with certain benefits upon entry and export of cargo. The main aim of this system was to:

i. simplify customs procedures for the movement of goods especially in the area of importation, transportation, and exportation by using the green lane;
ii. reduce bureaucratic red-tape;
iii. introduce a system of self accounting for the movement of goods to the Licenced Manufacturing Warehouse, Public Bonded Warehouse and the Private Bonded Warehouse.

This system was also to assist in the setting up of International Procurement Centres and Regional Distribution Centres which require large volumes of goods to be imported and exported. Customs officers at the point of entry especially KLIA and Port Klang have been directed to offer assistance to these Golden Clients by subjecting them to minimal entry and exit requirements and to expedite the solving of problems encountered by them.

The launching of this system is timely as it is in line with the objective of the Royal Malaysian Customs to achieve a world class status, especially when other countries around the world have introduced them under different names such as Australia which calls it Accredited Client System and Thailand, the Gold Card System.

Skill and Experience

The decision on whether to inspect the contents of a container is often based on careful observation and the skill and experience of the customs officer on duty at that time. Experienced officers are able to spot discrepancies on the Import Declaration Form which could indicate that the container may contain contraband or illicit goods. Companies with a dubious background or having a track record of wrongful declarations are at a higher risk of having their containers scanned. In most cases, customs officials depend on tip-offs from informers to nab the culprits.

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 Degree in Economics and Certificate in Customs Procedures from the Malaysian Customs Academy. He can be contacted at e-mail : customs@streamyx.com.

WORKSHOP 1

TAXATION FOR INDIVIDUALS

Venue: **PNB DARBY PARK, KUALA LUMPUR**

Date: Tuesday, 17 January 2006

Time: 9.00am - 5.00pm

WORKSHOP OUTLINE

- Self Assessment System for Individuals
- Residence Status
- Personal Relief, Rebate, Benefit-in-Kind
- Business and Non Business Income
- Preparation of Form B/BE
- Penalties Involved
- Income Tax Computation
- Public Rulings and Latest Development

WORKSHOP 2

TAXATION FOR SOLE PROPRIETOR AND PARTNERSHIPS

Venue: **PNB DARBY PARK, KUALA LUMPUR**

Date: Wednesday, 15 February 2006

Time: 9.00am - 5.00pm

WORKSHOP OUTLINE

- Field Audits – Areas of Concern
- Keeping Records of Transactions, Documents / Evidence Required
- Penalties Involved
- Preparation of Form B and Form P
- Income Tax Computation
- Public Rulings and Latest Development

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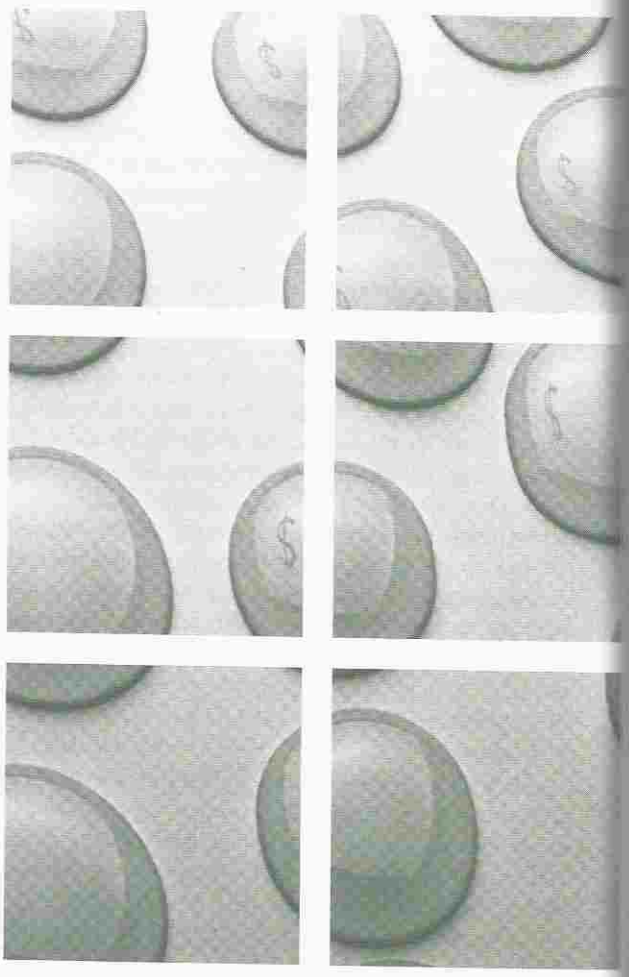
WORKSHOP



SPEAKERS

Wong Yok Chin is the Tax Director of RKT Tax Consultants Sdn. Bhd. and has approximately thirty years of experience in taxation matters. She has exposure to a wide variety of businesses and has also been involved in advising foreign investors on setting up businesses in Malaysia, which includes advising on the appropriate structure for carrying on a business in Malaysia, the various types of tax incentive and exemptions available, tax planning as well as the various legislations which an investor has to comply with.

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Evening Talk:
Capital Allowances – A Legal Perspective
Date: 12 Dec 2005

Workshop:
Tax Audits & Investigations
Date: 17 Dec 2005

Sums claimed under sec. 108 ITA requisition are not Tax or Duty but Statutory Debts - Time-bar applied

The taxpayer filed its income tax returns for the years of assessment 1987 to 1989 through its tax agent within the time limited and in accordance with the requirements under the *Income Tax Act 1967* ("ITA"). On 8 June 1990, the Director General of Inland Revenue ("DGIR") requested the tax agent to provide certain information including computation of the taxpayer's credit position under sec. 108 of the ITA for the years of assessment 1985 to 1989. The tax agent replied to this letter on 20 September 1990, duly furnished the requisite information and particularly setting out the taxpayer's sec. 108 account for the years of assessment 1985 to 1990. Prior to responding to DGIR's letter of 8th June 1990, the taxpayer on 28th August 1990 had filed Form C with the tax computation for year of assessment for 1990 thereafter continued to duly file Form C and relevant enclosures for years of assessment 1991 to 1998. Computation of the current position of the taxpayer's sec. 108 account for years of assessment 1990 to 1998 were also enclosed, in view of the DGIR's written request dated 8th June 1990.

After a period of silence of more than 11 years, on 3 October 2001, the tax agent received from the DGIR a requisition issued under sec. 108 of the ITA for years of assessment 1987 to 1993 in the prescribed Form S. These were all dated 12 September 2001. The taxpayer, through its agent, then wrote to the DGIR disputing liability to pay the requisition under Form S for years of assessment 1987 to 1993 on the basis that the requisitions were time-barred for having been issued more than six years after the expiration of years of assessment 1987 to 1993.

The principal issue in this case was whether the Form S, issued by the DGIR and all dated 12 September 2001 for years of assessment 1987 to 1993 under sec 108 of the ITA was time-barred.

Following *Ketua Pengarah Jabatan Hasil Dalam Negeri v Rheem (Far East) Pte Ltd, 1998 2 CLJ Supp 351 (Rheem's case)*, it was clearly established that - (a) sec. 108 requisition was different from an assessment and treats a debt requisitioned under sec. 108(5) (ie Form S) as something completely different from a tax assessed under sec. 91 (ie Form J or Form JA); and (b) sec. 108 requisition was not an assessment, and thus, it could not be appealed to the special commissioners, and the only avenue was to seek judicial resolution to apply for judicial review under Order 53 of the *Rules of the High Court 1980*.

In drawing the decision, the Judge cited sec. 33(1) of Limitation Act 1953 (the Act), which is reproduced here for reference:

"33. Application to the Government.

(1) Save as in this Act otherwise provided and without prejudice to section 3 of the Act, this Act shall apply to the proceedings by or against the Government in like manner as it applies to proceedings between subjects and for the purposes of this Act a proceeding by petition of right shall be deemed to be commenced on the date on which the petition is presented:

Provided that this Act shall not apply to any proceedings by the Government for recovery of any tax, duty or interest thereon, or to any forfeiture proceedings under any written law in force in Malaysia relating to custom duties or excise or any proceedings in respect of the forfeiture of a ship."

It can be seen from the foregoing, there is a proviso that qualifies the application of the Act to the Government. The Act will not apply to the second respondent in proceedings for recovery of "... *tax, duty or interest thereon or to any forfeiture proceedings*...". However in light of the DGIR's own argument which was upheld in *Rheem's case*, it is abundantly clear that the sums claimed under sec. 108(1) of the ITA requisition are a form of statutory debt. Such sums clearly do not constitute a tax. Further, it is clear sec. 108(5) of the ITA debts do not constitute duty within the meaning of the proviso to sec. 33(1) of the ITA as duty in this sense refers to federal taxes, in nature of custom duty, stamp duty, estate duty, etc. For ease of reference sec. 108(5) of the ITA is reproduced which reads as follows:

"(5) Where in relation to a year of assessment and a company the compared total exceeds the compared aggregate:

(a) a sum equal to the amount of the excess shall be a debt due from the company to the Government;

(b) the DGIR shall serve on the company a written requisition in the prescribed form calling upon it to pay the amount of the debt; and

(c) the debt shall be payable by the company to the DGIR on the service of the requisition."

Thus, the crux of the issue is whether the sum requisitioned for years of assessment for 1987 to 1993 is time-barred. Sec. 6(1)(d) of the Act reads as follows:

"Save as hereinafter provided the following actions shall not be brought after the expiration of six years from the date on which the cause of action accrued, that is to say -

(d) actions to recover any sum recoverable by virtue of any written law other than a penalty or forfeiture or of a sum by way of penalty or forfeiture".

The Judge is of the view that the second respondent's case against the taxpayer accrued and time started to run upon the taxpayer's submission. The submission of the taxpayer's returns/statements would have fulfilled the requirements of sec. 108(5)(a) of the ITA, that is, showing the amount of "debt due" to the second respondent. But the DGIR only issued Form S to recover the debt some eight to eleven years later. Clearly, the DGIR's action was time barred by virtue of sec. 6(1)(d) of the Act. The DGIR only acted after the expiration of six years from the date when the debt was due to the second respondent.

The judge concluded that the sums requisitioned by the DGIR for years of assessment of 1987 to 1993 are debts and time-barred under sec. 6(1)(d) of the Act, as they are clearly not 'taxes' within the meaning of sec. 33 of the same Act.

For the above reasons, the Judge allowed the taxpayer's application with costs.

Malayan United Industries Berhad v Ketua Pengarah Hasil Dalam Negeri & Kerajaan Malaysia

In the Court of Appeal Malaysia. Civil Appeal No R1-25-91 of 2002

Judgment delivered on 27 July 2005.

Norzilah binti Abdul Hamid and Norazira binti Abdul Wahab (Legal Officers, Inland Revenue Board) for the respondent.

Anand Raj and Irene Yong (Advocates & Solicitors, Messrs Shearn Delamore & Co) for the taxpayer.

Before: Dato' Md Raus Sharif J.

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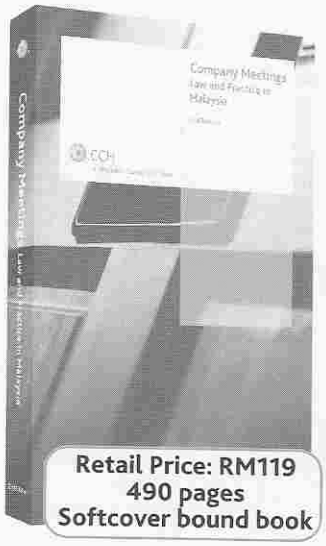

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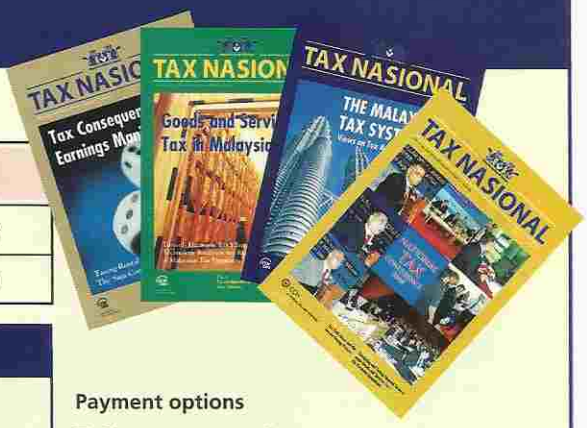

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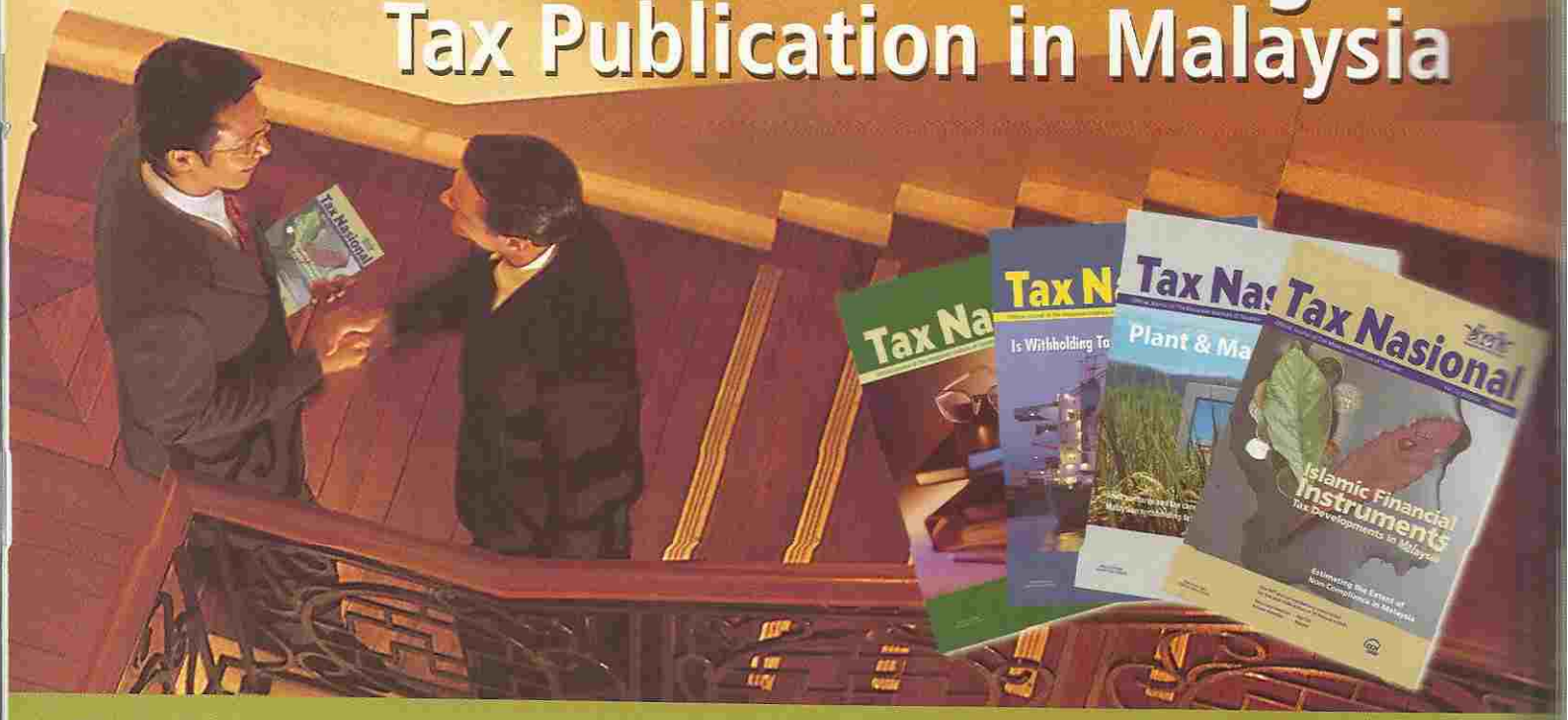

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