

TAX NASIONAL

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MIT Launches Examinations

Annual Tax Review 1994

Income Tax Orders 1994

Tax Planning For International
Licensing And Royalty Flows

Procedures for Application for
Approved Research

Memorandum to DGIR

Filing Programme For 1995

Service Tax

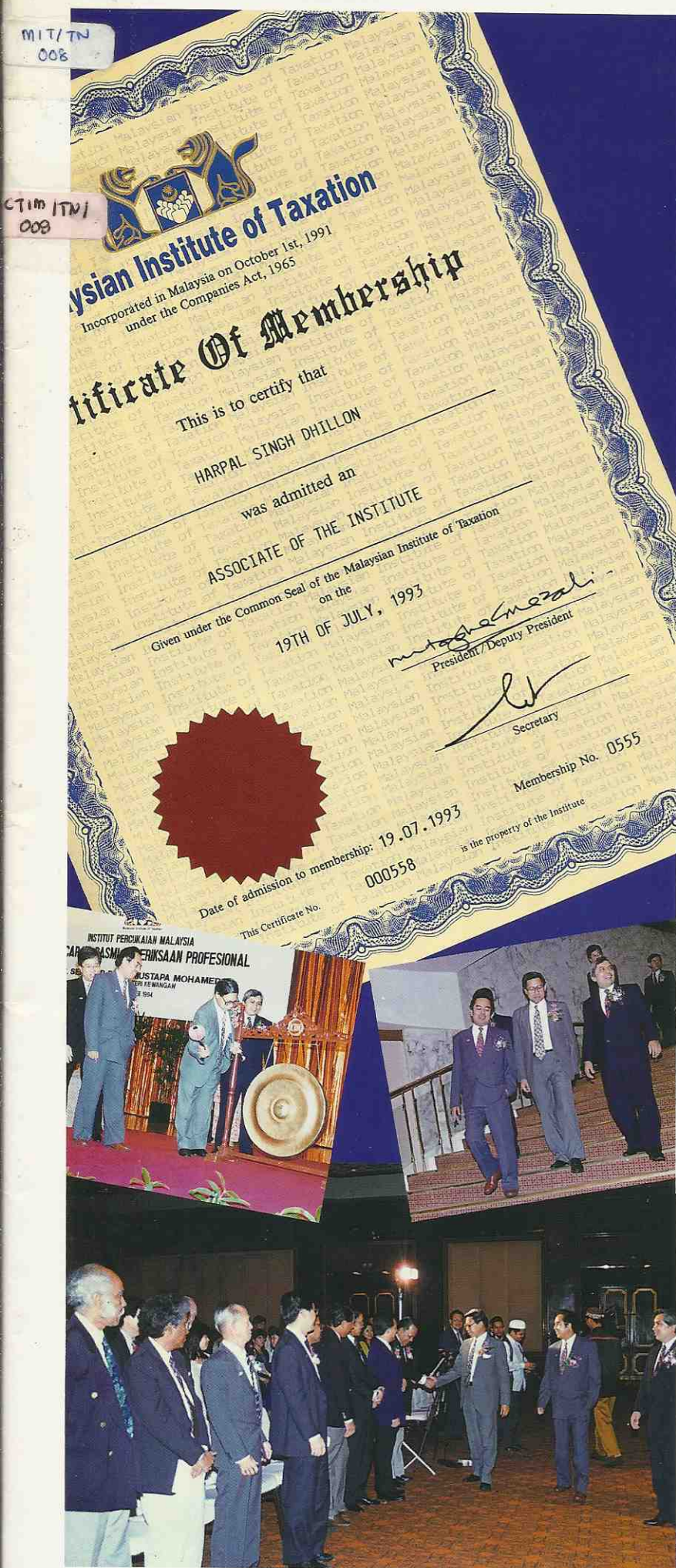
Institute News

Customs News

Students' Section:
The Taxation of Partnership Income



Malaysian Institute Of Taxation



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The Malaysian Institute of Taxation (MIT) is a company limited by guarantee incorporated on October 1, 1991 under Section 16(4) of the Companies Act, 1965.

The objectives of the Institute are, inter alia:

- To provide an organisation for persons interested in or concerned with taxation matters in Malaysia.
- To advance the status and interest of the taxation profession and to work in close co-operation with the Malaysian Institute of Accountants (MIA).
- To exercise professional supervision over the members of the Institute and frame and establish rules made herein for observance in matters pertaining to professional conduct.
- To provide examination for persons interested in or concerned with the taxation profession.

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MIT Launches Examinations



(from left) At the launching ceremony ... Deputy President and Chairman of Examination Committee, Mr Michael Loh, President En Ahmad Mustapha Ghazali, YB Senator Dato' Mustapa Mohamed and MIA President YBhg Dato' Hanifah Noordin.

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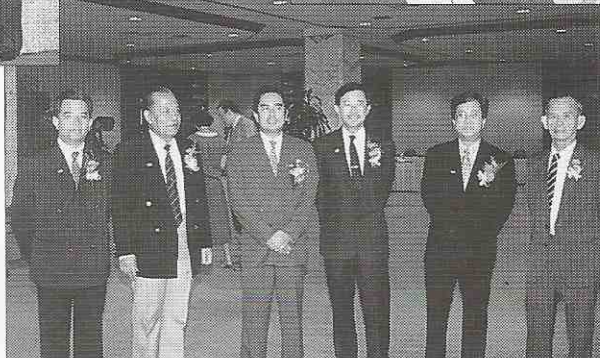
YB Senator Dato Mustapa Mohamed delivering his speech.

En Ahmad Mustapha Ghazali presenting a souvenir to YB Senator Dato' Mustapa Mohamed for graciously consenting to officiate the MIT Examination Launching.

A cross-section of the guests attending the launching.



The Institute's Council Members awaiting the arrival of the Deputy Minister... (left to right) Tuan Syed Amin Al Jefri, En Hamzah HM Saman, En Ahmad Mustapha Ghazali, Mr Chow Kee Kan, Mr Michael Loh and YBhg Tan Sri Lim Leong Seng, who is the Advisor to Council.



On 12th December 1994, the Institute launched its professional examinations at a leading hotel in Kuala Lumpur. This historic event which was officiated by the Deputy Finance Minister, YB Senator Dato' Mustapa Mohamed was attended by about 120 invited VIPs, senior government personnel, senior partners of audit and tax firms and members of the Institute. The MIT Examinations will be the first examinations for persons to qualify in tax to be introduced in this country.

The Deputy Finance Minister in his speech recognised the current shortage of qualified tax practitioners and the urgent need to address this situation. There are 2 million income tax earners who are taxable but only 1,268 tax practitioners who can act on behalf of income earners. Out of this number, there are only 234 agents who do purely tax work whereas the balance 1,034 practitioners are approved auditors who act as tax agents. He added that the rapid paced growth of the economy will bring foreign investments into the country thus requiring tax expertise. The planned introduction by the Government of the sales and service tax will further increase this demand. The action taken by the Institute is therefore welcomed and a step in the right direction to producing more qualified tax practi-

tioners. Emphasising that the syllabus of the examinations must be in touch with present times, he called on the Institute to continually review and update the syllabus. More importantly, the Deputy Finance Minister reminded the Institute to plan a program and train tax practitioners to be honest and trustworthy and that not only must a tax practitioner be competent but must contribute positively to the prosperity of the nation's economy.

Meanwhile, the President of the Institute, En Ahmad Mustapha Ghazali spoke on the need to safeguard the country's tax revenue and that tax payers receive a fair and equitable treatment from the assessors. In achieving this balance, tax practitioners must not only be competent to be able to provide adequate and sound advice to tax payers but also to adhere to their duty to ensure that all tax revenue due to the government are duly remitted. En Ahmad Mustapha in his speech concurred with the Deputy Finance Minister's call for tax practitioners to be of high integrity in the execution of their duties.

Y Bhg Dato' Hanifah Noordin, President of the Malaysian Institute of Accountants which sponsored the establishment of the Institute congratulated the Council and the Institute for

launching the examinations. He added that with this launching of the examinations, it heralds a new direction in the nation's education and training in the field of taxation.

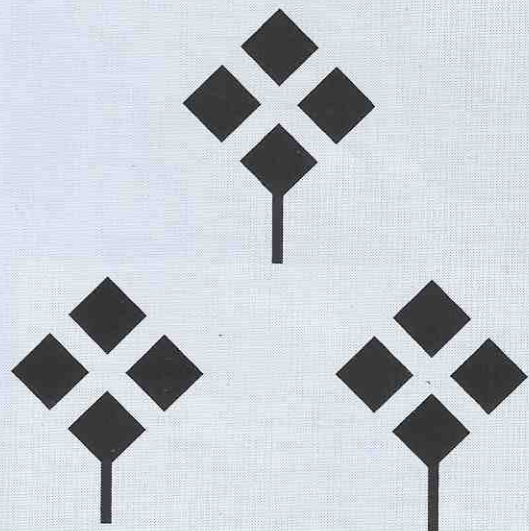
The Deputy President of the Institute and Chairman of Examinations Committee, Mr Michael Loh in his speech remarked that an important reason for the development of the examinations is the difficulty in finding qualified staff who will remain long in a firm. The MIT examinations will therefore be a more constructive manner to create a pool of qualified tax practitioners who will not only stabilise the excess demand but is more efficient in terms of cost and time saving. Therefore, Mr Loh hopes that firms will think about sponsoring their staff for the forthcoming examinations. The presence of a common professional examination for persons to qualify in tax will also ensure uniformity of professional standards of all student graduates.

The launching of the examinations was concluded by a slide presentation on the Institute and the examinations by Mr Khoo Chuan Keat, a senior member of the Examinations Committee.

(More about the Examination on page 30)

**The Council of the
Malaysian Institute of Taxation
wishes all our members and readers a**

*Selamat Hari Raya
Aidil Fitri*



Annual Tax Review

1994

A TAX CASES (other than Special Commissioner's Cases)

Two of the cases are analysed for member's reading and the name and reference number is stated for the others due to space constrain.

B SALE OF LAND BY HOUSING SOCIETY TO MEMBERS - WHETHER LAND WAS AN ASSET OR STOCK-IN-TRADE

FACTS

The Coop purchased land in 1956 with the primary object of building houses on the land and selling them to its members in order to achieve its objective of enabling its members to own houses.

The land was sub-divided.

In 1968, the Coop entered into several agreements with a housing developer, whereby the developer bought a portion of the lots and was obliged to sell the lots to the taxpayer's members at the same price.

The Coop agreed to bear the cost of infrastructure for the lots.

Demand for the houses was not good and 41 out of 101 lots were left unsold.

In order to cut its losses, the remainder of the land had to be sold and it was sold to the developer and to release it from its obligation to sell the remaining 41 lots to the Coop members. In return, the taxpayer was released from its obligation to construct the infrastructure.

THE REVENUE

Included the profits received from the disposal of the land, which it claimed to be gains from trading and therefore assessable to income tax and development tax.

The Revenue considered the value of the lots as stock-in-trade and the cost as the 1956 value.

THE SPECIAL COMMISSIONERS

The appeal was dismissed.

THE HIGH COURT

Answered the question in the affirmative and dismissed the appeal.

GROUND OF APPEAL

Taxpayer's appeal was based on the following grounds

- 1 It had not traded in land, i.e. the land was a capital asset and the profits were capital gains not liable to income tax.
- 2 Income tax was not payable as the sale to the developer was a forced sale as conceded by the special commissioners.
- 3 The taxpayer was made up of its members and therefore could not trade with itself under the concept of mutuality.
- 4 If at all the taxpayer was trading in land, the cost should be that in 1968 and not 1956.

SUPREME COURT

Answering the question in the negative and allowing the taxpayer's appeal.

Further reading

Lower Perak Co-operative Housing Society Bhd v Ketua Pengarah Hasil Dalam Negeri (1994) 2 AMR 34 p1735 / (1994) 2 MLJ 713

A2 ACCOUNTANT'S REPORT

FACTS

1975 YSS was admitted as an advocate and solicitor of the High Court.

1985 YSS went in partnership with two other persons to form the partnership YYN.

1990 On September 30, 1990 he left YYN and started practice under the name of PYY.

1991 YSS applies for the Sijil Annual (SA) for 1992.

The Bar Council (BC) request for the accountant's report in respect of YSS former firm.

YSS replies that, since he has left his former firm, he had no control over its financial affairs.

Subsequently meetings are held with the former partner (MY) to resolve the matter, and the BC allows extension of time to July 29, 1992.

Further extension is granted to December 31, 1992.

YSS and MY agreed that auditors be appointed by BC to examine the accounts of the former firm.

Auditor A is appointed and further extension of time of three months after December 31, 1992 is requested.

BC issues the SA for 1992 and 1993 pending the production of the accountants report.

Auditor A did not show any progress and a new Auditor B was appointed by the BC and extension of time to December 31, 1993 was granted.

1993 YSS on November 18, 1993, applied for a SA for the year 1994 but was refused.

Auditor B produced their report and the BC discovered that at January 1, 1990, the client's accounts were overdrawn by more than RM 1 million.

BC asked YSS and MY to explain the matter so as to enable the BC to consider whether to issue the SA for 1994.

YSS said that he could not offer any explanation as he had left the firm in 1990.

YSS requested that he be exempted under Rule 6 of the Accountant's Report Rules 1978 was rejected by the BC

will not recommend to the Registrar that a practice certificate be issued.

Further Reading

YSS v Majlis Pequam
(1994) 2 AMR 34

OTHER REPORTED DIRECT AND INDIRECT TAX CASES

A3 GOVERNMENT OF MALAYSIA v SARAWAK PROPERTIES SDH BHD
(1994) 1 MLJ 14

A4 GOH HOOI YIN v SEE GEOK HEOH & ANOR
(1994) 1 AMR 8 P454

A5 TAICHOI YU v GOVERNMENT OF MALAYSIA & ORS
(1994) 1 MLJ 677

A6 PUBLIC PROSECUTOR v MOHD ISA B DIN
(1994) 3 AMR 52 P2757

A7 NATIONAL LAND FINANCE CO-OPERATIVE SOCIETY LTD v DGIR
(1994) 1 MLJ 99

A8 GOVERNMENT OF MALAYSIA v JASANUSA SDN BHD
(1994) 1 AMR 10 p560

A9 PUBLIC PROSECUTOR v LAU SIEW NGUONG & ANOR
(1994) 2 MLJ 91

A10 PUBLIC PROSECUTOR v CHANG SIN CHAN & ANOR
(1994) 3 AMR 38 p 1975

A11 ATLANTIC SCOPE (M) SDN BHD v DIRECTOR GENERAL OF CUSTOMS AND EXCISE MALAYSIA
(1994) 3 MLJ 669

A12 GLOBAL PACIFIC TEXTILE INDUSTRIES SDN BHD (IN RECEIVERSHIP) v KETUA PENGARAH JABATAN KASTAM DAN EKSAIS & ORS
(1994) 3 MLJ 175

A13 UNITED STRAITS FUSO SDN BHD v TIMBALAN PENGARAH KASTAM, CAWANGAN

PASUKAN KHAS, KASTAM & EKSAIS DIRAJA MALAYSIA & 2 ORS
(1994) 3 AMR 49 p2618

A14 ABDUL BIN ALIDTNS, DATO & 2 ORS v PENGARAH KASTAM NEGERI, WILAYAH PERSEDUTUAN
(1994) 3 AMR 49 p2567

A15 MUI FINANCE BERHAD v MENTERI KEWANGAN, MALAYSIA
(1994) 2 AMR 23 p11

Note:

Special Commissioner's Cases have been reported separately in the journal, where there is an appeal and a case stated is prepared. Cases where there has been no appeal, will be reported in the Special Commissioner's Cases bound volumes, which are currently expected to be available towards the end of this year.

B DOUBLE TAX AGREEMENTS

Three new double taxation relief orders were gazetted during the year,

Papua New Guinea

Republic of Albania

Republic of Sudan

C TAX DEDUCTIONS

The following were gazetted during the year:

- 1 Income Tax (Deduction From Remuneration) Rules 1994, with effect from 1st January 1995.
- 2 Income Tax (Deduction From Emoluments : East Malaysia) (Amendment) Rules 1994, with effect from 1st January 1993.
- 3 Income Tax (Deduction From Emoluments : East Malaysia) (Amendment) (No. 2) Rules 1994, with effect from 1st January 1994.

The High Court rejected the appeal by YSS.

HIGH COURT

SUPREME COURT

An advocate and solicitor is in a position of a trustee vis-a-vis his client's money and must therefore produce a clean accountant's report in respect of all monies handled by any office of his partnership during any period which he is a partner.

BC is not concerned with the internal financial and other arrangements amongst partners.

If the respondent finds that an advocate cannot deliver a clean accountant's report, it is entitled to refuse to issue the SA and consequently

D AMENDMENTS TO THE INCOME TAX ACT

The Finance Act 1994 (Act 513) was gazetted on 24 February 1994

E SUBSIDIARY INCOME TAX LEGISLATION

Numerous exemptions under the income tax act were issued during the year and are included in this issue of Tax Nasional.

F CORRIGENDUM

The Income Tax (Exemption) (No. 49) Order 1993
The English text to PU(A) 414 published on the 9th December 1993 has been amended.

G REAL PROPERTY GAINS TAX ACT

The South East Asian Ministers of Education Organisation was exempted from RPGT.

H INVESTMENT INCENTIVES

- 1 Promotion of Investments (Promoted Activities and Products) (Amendment) Order 1994, which came into effect on 6th June 1992, included the following as a promoted industry:

Item V (16) Deproteinised natural rubber.

- 2 Promotion of Investments (Promoted Activities and Products) (Amendment) (No. 2) Order 1994, which came into effect on 28th October 1993, included the following as a promoted industry:

Item XIX (6) Ground support equipment for the aerospace industry.

- 3 Promotion of Investments (Promoted Activities and Products) (Amendment) (No. 3) Order 1994, which came into effect on 30th October 1993, included the following as a promoted industry:

Item VI

(6) Crude palm oil and meal.

(7) Refined palm oil, palm kernel oil.

4 Promoted Areas

The following are promoted areas with effect from 29th October 1993:

Eastern Corridor of Peninsular Malaysia
Kelantan
Terengganu
Pahang (not including the Districts of Lipis, Raub, Jerantut and Cameron Highlands except for the industrial areas approved by the State Government),
The District of Mersing in the State of Johore

Sabah

Sarawak

I DIALOGUE WITH IRD

This has been produced in our circular to members during 1994.

J TAX & BUSINESS INFORMATION, BUDGET NEWS

These have been produced in the Tax & Business Information Budget News 1995 booklet. A summary of the contents is as below;

Tax Tables

- A01 Income tax
- A02 Personal relief's and tax rebates
- A03 Scholar tax deductions from employment income
- A04 Capital allowances rates
- A05 Agriculture and forest allowances rates
- A06 Real property gains tax rates
- A07 Withholding tax rates
- A08 Double taxation agreements

Tax Information

- A09 Exemptions from income tax
- A10 Exemptions from real property gains tax

- A11 Benefits in kind not taxable
- A12 Benefits in kind - Inland Revenue Guidelines
- A13 Interest restriction - Inland Revenue Guidelines
- A14 Reinvestment allowance - Inland Revenue Guidelines
- A15 Operational headquarters - Inland Revenue Guidelines
- A16 Investment Incentives under the PIA 1986
- A17 Promoted activities and products
- A18 Double deduction for qualifying business expenses
- A19 Company dividends - taxable and non taxable
- A20 Tax checklist - important dates
- A21 Sales Tax
- A22 Service Tax
- A23 Import and Excise Duties - Exemptions and Drawbacks
- A24 Addresses of Inland Revenue offices
- A25 Addresses of Customs offices
- A26 Government revenue and expenditure

Business Information

- A27 EPF and SOCSO contribution rates
- A28 Manufacturing Licences
- A29 Guidelines on Foreign Investment
- A30 Immigration Laws
- A31 Banking and Finance
- A32 Exchange Control
- A33 Labuan Offshore Financial Center
- A34 Addresses of MIDA offices in Malaysia
- A35 MIDA organisation chart

K BUDGET PROPOSAL 1995

These were published in the December 1994 issue of Tax Nasional.

Q U O T E

**Hindsight
is always
twenty-twenty.**

Billy Wilder

INCOME TAX

(EXEMPTION/AMENDMENT)

ORDERS 1994

NO	TITLE	REFER P.U. (A)	DATE GAZETTE NOTIFICATION	SUBJECT	EFFECTIVE DATE
01	Income Tax (Return By Employers) Order 1994	01	01/06/94	Employers Return for Year Assessment 1993	Y/A 01/01/93
02	Income Tax Act 1967 (Section 44(6)) (No.1878)		03/03/94	List of Approved Institutions or Organisations for the purposes of Section 44(6)	Various dates
03	Income Tax Act 1967 (Section 44(6)) (No. 1879)		03/03/94	Withdrawal of Approval Under Section 44(6) to Institutions or Organisations	Various dates
04	Income Tax Act 1967 (Section 44(6)) (No. 2666)		03/31/94	List of Approved Institutions or Organisations for the purposes of Section 44(6)	Various dates
05	Income Tax Act 1967 (Section 44(6)) (No. 2667)		03/31/94	Withdrawal of Approval Under Section 44(6) to Institutions or Organisations	Various dates
06	Income Tax (Exemption) Order 1994	97	03/31/94	All income of the South East Asian Ministers of Education Organisation (SEAMEO) exempts from tax	Y/A 1973
07	Income Tax (Exemption) (No.2) Order 1994	98	03/31/94	Tax exemption for technical fees up to an amount of US\$155,325 of DRI/Mc Graw Hill received under an agreement for consultancy services dated 14/10/93	
08	Income Tax (Exemption) (No. 3) Order 1994	99	03/31/94	All income of the Huaren Education Foundation (excluding dividend income) exempt from tax	Y/A 1994 to Y/A 1998
09	Income Tax (Exemption) (No. 4) Order 1994	100	03/31/94	All income of the Malaysian Institute of Maritime Affairs (excluding dividend income) exempt from tax	Y/A 1994 to Y/A 1998
10	Income Tax (Deduction From Emoluments : (EM) (Amend.) Rules 1994	134	04/14/94	Tax deduction from emoluments : East Malaysia	
11	Income Tax (Exemption) (No. 5) Order 1994	138	04/21/94	The official emoluments received by the following officials for serving with the Forest Department, Sarawak exempt from tax. a) Robert Butler Stuebing P/P No: Z4970068 b) Richard Reuban Tenaza P/P No: I50343469 c) Hans Kristian Seip P/P No: G0210735-6	01/07/93 to 01/07/94 15/06/93 to 28/08/93 14/11/93 to 31/12/93

SUBSIDIARY LEGISLATION



NO	TITLE	REFER P.U. (A)	DATE GAZETTE NOTIFICATION	SUBJECT	EFFECTIVE DATE
12	Income Tax (Exemption) (No. 6) Order 1994	159	05/05/94	<p>d) Gordon Pickles P/P No: 802246B</p> <p>e) Kelso Jay Blakeney P/P No: EM260453</p> <p>i) All income of the KLCE General Fund (excluding dividend income) exempt from tax.</p> <p>ii) All income of the KLCE Compensation Fund (Excluding dividend income) exempt from tax.</p>	<p>i) 15/9/93 to 30/11/93</p> <p>ii) 01/02/94 to 31/03/94</p> <p>13/10/93 to 13/01/94</p> <p>Y/A 1994 to Y/A 1998</p> <p>Y/A 1994 to Y/A 1998</p>
13	Income Tax (Exemption) (No. 7) Order 1994	160	05/05/94	<p>The official emoluments received by the following officials for serving with the Enterprise Malaysia Canada Project exempt from tax.</p> <p>a) Tremain Tanner P/P No: HA 877147 (Canada)</p> <p>b) Kim Harker P/P No: FV 559885 (Canada)</p> <p>b) Mark Green P/P No: EM 273408 (Canada)</p>	<p>01/03/91 to 31/12/95</p> <p>01/01/93 to 31/12/95</p> <p>18/01/91 to 31/12/95</p>
14	Income Tax (Exemption) (No. 8) Order 1994	183	05/19/94	<p>Tax exemption for the following banks in respect of interest received from Petriam Nasional Bhd pursuant to Loan Agreement dated the 23/08/93 with banks.</p> <ol style="list-style-type: none"> 1) BBMB International Bank (L) Ltd. 2) Maybank International (L) Ltd. 3) The Industrial Bank Of Japan, Ltd. 4) Nippon Life Insurance Company 5) The Bank Of Tokyo, Ltd. 6) D & C Bank (L) Ltd. 7) Public Bank (L) Ltd. 8) The Dai-Ichi Kangyo Bank Ltd. 9) The Fuji Bank, Limited. 10) The Long-Term Credit Bank of Japan 11) The Sakura Bank Limited 12) The Sanwa Bank Ltd 13) The Sumitomo Bank Ltd 14) The Tokai Bank Limited 	
15	Income Tax (Exemption) (No. 9) Order 1994	184	05/19/94	<p>Tax exemption for technical fees up to an amount of Dfl 691,830 of Netherlands Airport Consultants B.V of The Hague receivable under an agreement for consultancy services dated the 11/12/92 with the Government of Malaysia.</p>	
16	Income Tax (Exemption) (No. 10) Order 1994	185	05/19/94	<p>Tax exemption for technical fees up to an amount of Dfl 417,382 of Netherlands Airport Consultants B.V of The Hague receivable under an agreement for audit services dated the 29/06/93 with Government of Malaysia.</p>	

SUBSIDIARY LEGISLATION

NO	TITLE	REFER P.U. (A)	DATE GAZETTE NOTIFICATION	SUBJECT	EFFECTIVE DATE
17	Income Tax (Exemption) (No. 11) Order 1994	192	05/26/94	Tax exemption on gains or profits up to an amount equivalent to gains or profits accruing on a deposits of RM50,000 for a calender year which accrues to an individual for the basis year for year assessment in respect of money deposited in any saving - Account under the Interest-Free Banking Scheme (IFBS) with bank of finance company licensed under the Banking and Financial Institutions Act 1989.	
18	Income Tax (Exemption) (No. 12) Order 1994	193	05/29/94	All income of the following Yayasan listed (excluding dividend income) exempts from tax. i) Yayasan Islam Kelantan ii) Yayasan Sarawak iii) Yayasan Terengganu iv) Yayasan Perak v) Yayasan Kelantan Darulnaim vi) Yayasan Pahang vii) Yayasan Negeri Sembilan	Y/A 1984 to Y/A 1996 Y/A 1983 to Y/A 1996 Y/A 1983 to Y/A 1996 Y/A 1984 to Y/A 1985 Y/A 1987 to Y/A 1996 Y/A 1989 to Y/A 1996 Y/A 1990 to Y/A 1996
19	Income Tax (Exemption) (No. 13) Order 1994	194	05/26/94	All income of the following Yayasan listed (excluding dividend income) exempts from tax i) Yayasan Pelajaran Johor ii) Yayasan Melaka	Y/A 1994 to Y/A 1996 Y/A 1995 to Y/A 1996
20	Income Tax (Exemption) (No. 14) Order 1994	195	05/26/94	All income of the Pos Malaysia Berhad (excluding dividend income) exempts from tax.	Y/A 1993 to Y/A 1995
21	Income Tax (Exemption) (No. 15) Order 1994	196	05/26/94	The Minister exempt from all the provisions of the Income Tax Act 1967 in respect of a) a grant of remembrance allowance granted under Sec. 3 b) a grant to next of kin of recipient under Sec. 5 & 6 payable pursuant to the Seri Pahlawan Gagah Perkasa (Remembrance Allowance) Act 1990	Y/A 1984 and subsequent Y/A
22	Income Tax (Exemption) (No. 16) Order 1994	197	05/26/94	Official emoluments received by Mr Albert Fuller, P/P No: 011886461 for serving with the Asia Foundation, exempt from tax.	3/12/93 to 02/12/97
23	Income Tax (Exemption) (No. 17) Order 1994	198	05/26/94	Official emoluments received by Cik Amzi Sharon Crenshaw P/P No : 100993179 for serving the ASEAN Environmental Improvement Project, exempt from tax.	01/11/93 to 01/11/93

SUBSIDIARY LEGISLATION



NO	TITLE	REFER P.U. (A)	DATE GAZETTE NOTIFICATION	SUBJECT	EFFECTIVE DATE
24	Income Tax (Exemption) (No. 18) Order 1994	199	05/26/94	Officials emoluments of 34 officials for serving the Government of Malaysia as consultants under the "Commonwealth Fund For Technical Cooperation, under a Memorandum of Understanding dated the 11/11/74 between Govrn. of Malaysia & Commonwealth Secretariat.	
25	Income Tax Act 1967 (Section 44(6)) (No. 5671)		05/26/94	List of Approved Institutions or Organisations	Various dates
26	Income Tax Act 1967 (Section 44(6)) (No. 5672)		05/26/94	Withdrawal of approval under Section 44(6) to institutions or organisations	Various dates
27	Income Tax Act 1967 (Section 44(6)) (No. 5673)		05/26/94	Change of name institutions or organisations approved under section 44(6)	
28	Income Tax (Exemption) (No. 19) Order 1994	221	06/09/94	Official emoluments received by Paulino L. Manalo from Philippines, P/P No: E149644 for serving with the Asean Plant Quarantine Centre and Training Institute, exempts from tax.	02/10/88 to 20/02/94
29	Income Tax (Exemption) (No. 20) Order 1994	222	06/09/94	All income of the Perbadanan Kemajuan Bukit Fraser (excluding dividend income) exempt from tax.	Y/A 1980 to Y/A 1996
30	Income Tax (Exemption) (No. 21) Order 1994	238	06/16/94	All income of the Composite Technology Research Malaysia Sdn Bhd (excluding dividend income) exempt from tax.	Y/A 1992 to Y/A 1996
31	Income Tax (Exemption)	238	07/21/94	Tax exemption for The Malaysia Fund, Inc in respect any income derived from Malaysia where any income received by the Fund: i) For the period from the 1st Nov 87 to the date one day before the date of completion of the Second Issue, the whole of the income shall be exempt from tax. ii) For the period from the date of completion of the second Issue to the 31st Oct 95, a portion of the income shall be exempt from tax, which portion shall be determined by multiplying the amount of the income by the fraction calculated	Y/A 1992 to Y/A 1996 (Ref. to the order No: 22)
32	Income Tax (Deduction From Emoluments: East M'sia)(Amend.)	317	08/18/94	Amendment of deduction from emoluments East Malaysia	
33	Double Taxation Relief (The Government of The Independent State of Papua New Guinea) Order 1994	327	09/01/94	Agreement dated 20/05/93 between the Government of M'sia and the Government of Papua New Guinea for the avoidance of double taxation with respect to taxes on income	
34	Double Taxation Relief (The Government of the Republic of Albania) Order 1994	340	09/15/94	Agreement dated 24/01/94 between the Government of M'sia and the Government of the Republic of Albania) Order 1994	

SUBSIDIARY LEGISLATION

NO	TITLE	REFER P.U. (A)	DATE GAZETTE NOTIFICATION	SUBJECT	EFFECTIVE DATE
35	Income Tax (Exemption) (No. 23) Order 1994	341	09/15/94	All income of the Persatuan Nelayan Kebangsaan (NEKMAT) (excluding dividend income) exempts from tax.	Y/A 1/12/1990 to Y/A 31/12/1998
36	Income Tax (Exemption) (No. 24) Order 1994	342	09/15/94	All income of the Malaysian Futures Clearing Corporation Sdn Bhd (exclud- ing dividend income) exempts from tax	Y/A 1994 to Y/A 1998
37	Income Tax (Exemption) (No. 25) Order 1994	343	09/15/94	All income of the South Investment, Trade and Technology Data Exchange Centre (SITTDEC) exempts from tax	Y/A 1993 and Subsequent Y/A
38	Income Tax (Exemption) (No. 26) Order 1994	439	11/10/94	Official emoluments received by the following for serving with the Forest Department Sarawak, exempt from Sarawak a) Dr Robert Barnabas Grubh P/P No: M 162685 b) Raleigh Albert Blouch P/P No: Z 557034 c) En Robert Butler Stuebing P/P No: Z 4970068 d) En Svend Korsgaard P/P No: A 002677147 e) En Adam Ferrie P/P No: EM 270142 f) En Gordon Pickles P/P No: 802246 B g) Dr Nils H.H Svaqvist P/P No: UR 924806 h) Mr Kurt Bostrom P/P No: 43 298384	22/06/94 to 22/09/94 19/04/94 to 18/04/94 02/07/94 to 30/09/94 04/03/94 to 04/07/94 25/02/94 to 28/03/94 01/04/94 to 30/04/94 01/04/94 to 30/06/94 15/02/94 to 14/04/94
39	Income Tax (Exemption) (No. 27) Order 1994	440	11/10/94	All income of the National Institute of Occupational Safety and Health (Excluding dividend income) exempt from tax	Y/A 1993 to Y/A 1997
40	Income Tax (Exemption) (No. 28) Order 1994	442	11/10/94	All income of the Malaysia Airport Bhd (excluding dividend income) exempt from tax	
41	Income Tax (Exemption) (No. 29) Order 1994	443	11/10/94	All income of the Sukom Ninety-Eight Berhad (excluding dividend income) exempt from tax	Y/A 1993 to Y/A 1995
42	Income Tax (Exemption) (No. 30) Order 1994	444	11/10/94	Tax exemption for the Institute Sultan Iskandar of Urban Habitat and Highrise, in respect of RM1m received by way of grant from the Sultan Iskandar Johor Foundation	
43	Income Tax (Exemption) (No. 31) Order 1994	455	11/10/94	Official emoluments of Puan Penelope Bridget Surrey Dane of Ireland, P/P No: K011429, in M'sia serving under the Vietnamese Boat People Assistance exempt from tax	Y/A 01/09/94 to Y/A 28/02/94
44	Income Tax (Exemption) (No. 32) Order 1994	463	11/17/94	All income of the Perbadanan Kemajuan Tanah Adat Melaka (PERTAM) (excluding dividend income) exempt from tax	

SUBSIDIARY LEGISLATION



NO	TITLE	REFER P.U. (A)	DATE GAZETTE NOTIFICATION	SUBJECT	EFFECTIVE DATE
45	Income Tax (Exemption) (No. 33) Order 1994	474	11/24/94	Tax exemption for Datotek Incorporated of USA, in respect of payment receivable for services under an Agreement with Government of M'sia dated 26/12/1989	
46	Income Tax (Exemption) (No. 34) Order 1994	473	11/24/94	Tax exemption for Racial Marine System LTD. of UK, in respect of payment receivable under an Agreement (Contract No. KP/BEK-1/LAUT/D/52/87) with the Government of Malaysia dated 31/05/88	
47	Income Tax (Exemption) (No. 35) Order 1994	476	11/24/94	Tax exemption for FFV Aerotech of Kingdom of Sweden, in respect of payments for services receivable under an Agreement (Contract No. KP/BEK-1/UDARA/C/03/1988) with the Government of Malaysia dated 2nd August 1988	
48	Income Tax (Exemption) (No. 36) Order 1994	477	11/24/94	Tax exemption for Ferranti Defence Systems Limited of Scotland, in respect of payments for services payable under an Agreement (Contract No. KP/BEK-2/SENJATA/A/12/1988) with the Government of Malaysia dated 10/09/88	
49	Income Tax (Exemption) (No. 37) Order 1994	478	11/24/94	Tax exemption for AEL (R.P.V) Ltd of the UK, in respect of payments receivable under an Agreement (Contract No. KP/BEK-2/SENJATA/A/8/1988) dated the 6th August 1988 with the Government of Malaysia	
50	Income Tax (Exemption) (No. 38) Order 1994	479	11/24/94	Tax exemption for IPTN Nusantara Aircraft Industries Ltd of the Republic of Indonesia, in respect of payments receivable under an Agreement (Contract No. PERB/K & B/65/1987) with the Government of Malaysia dated 27th June 1987	
51	Income Tax (Exemption) (No. 39) Order 1994	487	12/01/94	All income of the Institute of Strategic and International Studies (excluding dividend income) exempt from tax	Y/A 1994 to Y/A 1996
52	Income Tax (Exemption) (No. 40) Order 1994	509	12/15/94	All income of the Malaysian Equine Council (excluding dividend income) exempt from tax	Y/A 1994 to Y/A 1998
53	Income Tax (Exemption) (No. 41) Order 1994	510	12/15/94	Tax exemption for the Ontario Hydro Canada, in respect of US\$285,000 received from the Asian Development Bank for technical assistance provided under an Agreement dated 21/10/88 in respect of the Sarawak Electricity Supply Corporation (SESCO)	
54	Income Tax (Exemption) (No. 42) Order 1994	518	12/22/94	All income of the Institut Jantung Negara Sdn Bhd (excluding dividend income) exempt from tax	Y/A 1994 to Y/A 1996
55	Income Tax (Exemption) (No. 43) Order 1994	544	12/29/94	All income of the Malaysian External Trade Development Corporation (excluding dividend income) exempt from tax	Y/A 1994 to Y/A 1998

Tax Planning For International Licensing And Royalty Flows

(This article will be published in four parts)

PART B CONSIDERATION/REMUNERATION FOR LICENSING

DIFFERENT REMUNERATION METHODS

In practice there are a great number of different remuneration methods for licensing agreements depending on the character of the agreement. In the following only the most frequently used methods shall be discussed.

1 FIXED AMOUNT

In case a fixed amount is agreed upon as remuneration for a licensing agreement there will only be one payment (lump sum) and no ongoing payments. A fixed amount may be chosen as remuneration where possibilities to control the output of the licensed products do not exist or are too burdensome. Furthermore it may be applied in cases of short-lived know-how or as a settlement terminating an infringement of the protected right

In case of a fixed amount as licence fee the distinction between the sale of an intangible and a licence as outlined in this chapter on page becomes quite important.

In case a sale is given the acquisition costs of the acquirer may be subject to depreciation (please refer to chapter 6.2.5. Amortisation hereinafter). If a licence is given, the royalties result immediately in business expenses for the licensee. In case a lump sum is paid for several years of use of the intangible this lump sum would have to be apportioned to the corresponding years.

If the economical substance of the

If the economical substance of the intangible is transferred by alienation usually a sale will be given

intangible is transferred by alienation usually a sale will be given. On the contrary the letting of the mere right to use the intangible will on principle be regarded as a licence. One of the characteristic items to distinguish between sale and licensing is the existence of a time limit. Even if it is uncertain whether and when the licence will actually end (because of contractual prolongation options) a time limit is characteristic for a licence, whereas the alienation of an intangible usually transfers for a theoretically unlimited time the substance of the intangible to the purchaser. However, the use of an intangible is always limited to its useful life. As licence agreements often cover the useful life of an intangible it is very difficult to make a clear distinction between sale and licence in these cases. Some tax authorities adopt a substance versus form approach creating a so-called economical ownership of the licensee in case the licensor as legal owner of the intangible is actually substantially hindered to execute his rights during the useful life of the intangible. However, the OECD Model Convention does not suggest to apply this economic approach in the cases concerned. As lump sum payments are difficult to handle taxwise the temporary 1993 US-regu-

lations on transfer pricing do not deal with this kind of payment. Even a proposal is not yet made.

2 ONGOING PAYMENTS

Ongoing fees are a common practice as method of remuneration in licensing agreements. These payments are made on a regular basis, e.g. turnover related ongoing payments. Often settlement and payment of the licence fee are due on a quarterly, semi-annual or annual basis.

Besides ongoing payments in practice there are also other types of remuneration, e.g. transfer of a part of the goods produced under the licence, purchase of raw material from the licensor, or granting of a licence by the licensee which can be combined with ongoing payments.

Regarding ongoing payments also a distinction between a sale with instalments and a licence agreement must be made. Notwithstanding the other indications for a sale, respectively a licence, which are outlined later in this chapter, the following criteria may help to clearly separate sale and licence. If a recurrent obligation for rendering accounts is stipulated and the amount of payments is depending on these accounts, this could be an indication for a licence in contrast to a sale with the purchase price to be paid in fixed instalments.

It is not unusual that during the use of the licence for a patent or know-how experience is gained and improvements are made by the licensee, which in case of return flow to the licensor

are paid for by the licensor. In case such return flow of improvements is anticipated in the licensing agreement it usually will have reduced the licence fee, thus no extra licence fee is payable by the licensor. If reciprocal exchange of experience is stipulated in the licensing agreement one may regard the exchanged experience as equal in value, hence no fee would have to be paid in this regard.

In case of related parties the determination whether and which amount of remuneration should be paid to the party developing the improvements is a transfer pricing issue. Therefore, the improvements have to be valued at fair market value and taken into consideration when assessing the licence fee in the original licensing agreement or of an improvement amendment thereto to achieve an overall arm's length transfer price. Given the nature of these improvements as being related to the specific patent or know-how, extreme care has to be taken of the valuation process to avoid transfer pricing problems in future tax audits.

3 PACKAGE FEES

Among related enterprises very sophisticated agreements and far-reaching arrangements are usual. Cross-licensing contracts may be found as well as a licence pool which is set up on agreement by the related parties. World-wide operating enterprises often use a package deal where all members are entitled to use the trademarks, trade names, patents and other intangible property developed by any member of the group. Normally for this right to use a package fee is agreed upon, thus avoiding the difficulties of splitting the fee for the package into different categories. Such a package fee may also be found with regard to contracts where a company owning several intangible properties grants the right to use all or a bundle of these intangibles to a licensee.

Difficulties may arise where a trademark is similar to the firm's name. In these cases the tax offices could challenge the remuneration related to this specific trademark. One argument brought forward is that for the general support by the group, including the

right to use the group's name, no licence fee can be charged by the parent company. According to national tax jurisdiction the shareholder generally provides his name without remuneration for the purpose of creating a company's trade name, thus indicating that exceptions are possible. Such an exception is discussed and may be accepted by the tax auditor in favour of group names, which are used like a brand name, e.g. certain chains in the restaurant and hotel business where the subsidiaries appear on the market as part of these chains. In such cases the group names have the same marketing advantages as trademarks and have as a symbol for special quality and class an eminent marketing importance.

In case the tax auditor does not accept a remuneration for some of the intangibles in the package, the package fee would have to be unbundled

In case the tax auditor does not accept a remuneration for some of the intangibles in the package, the package fee would have to be unbundled. Thus, the portion of the fee appertaining to the unaccepted intangible would be excluded from deduction. Correspondingly, the withholding tax rates on royalties should not be applicable on the unallowed part of the package fee.

If the tax authorities regard the disallowed part of the package fee as a hidden distribution, the withholding tax rates on dividends seems to be appropriate.

4 DOWNPAYMENTS

In case of know-how licensing sometimes a down payment is agreed upon which constitutes the participation of the licensee in the research and development costs of the licensor and is not set off against the ongoing royalty payments.

Such a down payment is justified by the performances executed in advance

by the licensor, e.g. transfer of documents and know-how. Even in case the documents are handed back to the licensor, these performances could not be undone to full extent. Therefore, a lump sum payment independent of the contractual period is often recommendable.

A down payment generates an interest advantage for the licensor as he receives a part of the consideration for the licensing up front. Therefore, the licensee in an arm's length situation will ask for a discount on the licence fee in return. According to US transfer pricing regulations such discounts have to be taken into consideration when assessing an arm's length licence fee and down payment among related parties.

5 TRADE OFF BETWEEN LICENSING AND SALE

As the transfer of an intangible generally results in a taxable capital gain which is, however, in several countries not subject to withholding tax whereas in the contrary royalties often are subject to withholding tax but do not result in a capital gain, a distinction must be made between the sale of an intangible and a licence.

The sale of an intangible (such as a patent) normally occurs when the transferor (seller) relinquishes to the transferee (purchaser) all rights associated with the intangible property. To determine whether there has been a sale several aspects of the transfer agreement should be examined, such as its duration, payment terms, geographic scope, field of application, and exclusivity or non-exclusivity.

Further distinctive criteria may be found in the tax authorities' regulations regarding the economic ownership in case of leasing agreements. German tax authorities for example have issued detailed regulations how to determine economic ownership in case of leasing of both movable assets and real estate.

Although these leasing rules are often very technical and specifically tailored to leasing agreements they may be applied analogous to licence agreements.

In case the transaction does not convey sufficient rights to constitute a sale, it is generally regarded as a licence (or possibly a contract for services). However, the mere designation of the transfer as a "sale" or a "licence" by the parties may not necessarily result in the corresponding categorisation for tax purposes. An exclusive "licence" in perpetuity for substantially all of the rights to an intangible may be considered a sale for tax purposes. A purported "sale" of less than all substantial rights might in the same manner be regarded for tax purposes as a licence.

With regard to the difficulties which may occur concerning the depreciation of intangibles please, refer to the chapter on Opportunities - Amortisation in Part D on Tax Planning Considerations, Opportunities and Pitfalls.

CALCULATION BASIS FOR LICENCE FEES

The licence fee may be calculated on a per unit basis, e.g. per unit sold or unit manufactured, on a sales base or may even be profit related. All types of remuneration are connected with different tax considerations.

1 TURNOVER RELATED LICENCE FEE

In case of a turnover related licence fee a specific percentage of the sales price is the calculation basis. To avoid later discussions due care must be taken when defining the relevant turnover as calculation basis.

It should be explicitly stipulated in the agreement which items do reduce the relevant turnover and which not, e.g. rebates granted by the licensee, incidental expenses as freight, insurance, packaging, VAT and custom duties.

There are different instants which may be chosen for timing the claim for the licence fee, e.g. conclusion of the sales contract with the customer, production of the licensed product, delivery of this product, issuance of the invoice or collection of the customer's payment.

In all but the last case, it is recom-

mendable to clarify whether receivables of the licensee out of the licensed production which turn out to be irrecoverable still qualify as relevant turnover for a licence fee or have to be deducted.

In case delivery of the licensed products generates the licence fee claims, the stock of licensed products is not yet subject to the fee.

Regarding licensees which deliver to third party customers as well as to affiliated companies it should be stated whether sales to other group members qualify as relevant turnover and in case of an affirmative answer how the transfer price as licence fee basis is calculated.

All types of remuneration are connected with different tax considerations

As one may imagine the documentation of the relevant turnover is very difficult and necessarily reveals a considerable amount of the calculation data to the licensor for inspection.

2 LICENCE FEE PER UNIT MANUFACTURED/SOLD

Licence fees based on a calculation per unit manufactured or sold are frequently found in practice, because this calculation is rather uncomplicated. In contrary to the turnover related licence the parties are not obliged to grant each other detailed inspection of their calculation documents as the output of the licensee's production or the number of units sold is easily to ascertain and to control by the licensor. As a fixed amount per unit manufactured or sold is agreed upon as licence fee this licence calculation basis is independent from unstable sales prices or profit margins of the licensee. In case of the manufactured units as relevant basis unsold stock is already subject to the licence fee.

According to sec. 482 IRC US-transfer pricing law requires that the equivalent for an intangible has to be commensurate with the income attributable to the intangible at the

licensee's level. Theoretically it might be possible to meet this requirement also in case of royalties based on units manufactured or sold. In practice, however, this will become difficult. Above all, in order to meet the commensurate with the income standard the licensor has to be informed about the profitability of the licensee.

3 MINIMUM LICENCE FEE

Often in case of an exclusive licence agreement the licensor has a vital interest that the licensee makes actually use of the licence. To force the licensee to comply with the obligation to execute the licence a minimum fee clause may be used. Usually an annual minimum amount has to be paid after a certain starting period which will be increased with the further continuance of the agreement. Such a minimum licence fee may be combined with a decreasing ongoing royalty payment to provide an incentive for additional use of the granted right.

In the alternative (genuine minimum licence) the licensee has to pay the minimum licence fee even in case the relevant minimum turnover has not been achieved. Such a clause may well secure the compliance with the obligation to execute the licence.

The second alternative (non-genuine minimum licence) grants - in case the minimum turnover is not achieved - to the licensor either the right to terminate the contract or the possibility to convert the exclusive licence into a non-exclusive licence. Often the licensee may prevent these consequences by payment of the minimum licence fee.

4 PROFIT-RELATED LICENCE FEE

Furthermore, the parties of the licence agreement are free to choose a profit-related licence fee where the licensee has to pay a certain percentage of his profit out of the licence as licence fee. One major disadvantage of a profit-related licence fee is the possibility of arguments between the parties about the appropriate method of determining profits. Naturally, this calculation basis requires to a far greater extent than an output-related licence fee the disclosure of calcula-

tion documents by the licensee to the licensor. In practice a profit-related licence fee only seems to be recommendable, if the licensee only produces licensed products. However, it has to be considered that tax authorities tend to focus on the return from the licence in order to determine the arm's length equivalent (see German Administrative Principles no. 5.2.3. and US regulations (1.482-4T(e)(2)(i); for details refer to the chapter on Transfer Pricing - General Principles in Part C on Tax Treatment of Licensing.

5 SLIDING SCALES

In case the licensee produces under the licence a high output, e.g. electronic semiconductors, often a degressive turnover related licence is agreed upon whereby the licence rate may decline gradually (for example from 6 p.c. to 0.6 p.c.) with the increasing licensed production. In such a case each lower rate is applicable only to those sales exceeding a certain number. The degressive scale provides an incentive to the licensee to sell a higher quantity.

The new temporary US regulations on transfer pricing explicitly allow that in certain circumstances the price, for a controlled transfer of property may, for a limited time, be other than, the amount charged in an otherwise comparable uncontrolled transaction. Prerequisite is that the controlled transfer is subject to a pricing strategy that is undertaken to enter new markets, to increase a product's share of an existing market, or to meet competition in an existing market (market share strategy).

Furthermore, this concept requires that the taxpayer has analysis to demonstrate that it is reasonably likely that such a strategy result in future profits for the U.S. taxpayer. Such profits must reflect an appropriate return on the costs incurred to implement the strategy. Additionally, the strategy can only be used for a reasonable period of time, taking into consideration the industry and product in question.

Therefore, a lower than normal arm's length royalty rate may be chosen in these cases of market share strategy.

ESTABLISHING THE COMPENSATION

With regard to the establishing of the compensation no general accepted calculation guide-lines exist. Therefore, different approaches to find an appropriate remuneration are discussed and used in practice.

With regard to licence agreements between affiliated parties, tax authorities require that the fee is arm's length, e.g. corresponds with the fee of an uncontrolled comparable licence agreement (comparable uncontrolled transaction). For details about the establishing of an arm's length licence fee please refer to the chapter on Transfer Pricing - General Principles in Part C on Tax Treatment of Licensing. The new US regulations on transfer pricing require that the licence fee has to be commensurate with the income out of the licence for details refer to the chapter on Conflicts between the rules of different countries / New US regulations on transfer pricing in Part C on Tax Treatment of Licensing.

Licence fees based on a calculation per unit manufactured or sold are frequently found in practice, because this calculation is rather uncomplicated

1 DATABASES

Efforts to build up a collection of "usual" licence fees agreed upon by third party licensors performing same or similar business activities seem to many practitioners of great value with regard to tax audits. However, one has to keep in mind that nearly every case is different from the other. These differences quite often require adjustments to make the cases comparable.

Nevertheless, tax authorities in some countries, e.g. Germany, do collect all licence fee data gained by tax auditors during tax audits and use these data as a guide-line for determining appropriate royalties between affiliated parties. It may be doubted, whether such collections are very helpful to other tax payers as they only disclose the mere figures of the

licence fee percentage, without the underlying documents, circumstances and calculations which are not open to the public due to the tax secrecy, but would be essential for a comparison.

As experience shows, it is, however, possible to learn indirectly about the contents of this data base, e.g. by the licence fee figures of official statements by the competent office operating the data base stated in tax audit reports. Naturally, these figures only relate to one specific case and its specific circumstances.

2 COMPARABLES

For two transactions to be considered comparable under the new US regulations on transfer pricing, an uncontrolled transaction need not to be identical or exactly comparable to the controlled transaction, but must be sufficiently similar so that it provides a reasonable and reliable benchmark for determining whether the controlled transaction led to an arm's length result. A reasonable number of adjustments may be made to account for material differences between the controlled and uncontrolled transactions, if such differences have a definite and reasonably ascertainable effect on prices or profits. Such adjustments should be based on commercial practices, economic principles, or statistical analyses, as applied to the available data. These general standards of comparability are subject to modification under the specific provisions of certain applicable methods, e.g. stricter limitations apply regarding the comparable uncontrolled price method.

When determining comparability the following factors must be considered.

Whether the functions performed are comparable is determined by a comparison based upon a functional analysis, which identifies and compares the economically significant activities actually undertaken or to be undertaken by the taxpayers in both controlled and uncontrolled transactions.

Furthermore a comparison of the risks borne in each transaction is required.

In a first step it must be determined

which controlled taxpayer bears the risks associated with the transaction, which includes a consideration of whether the income earned by that taxpayer over a reasonable period of time is commensurate with the risk assumed.

In a second step it has to be determined whether the risks borne by the controlled taxpayer are comparable to those borne by the uncontrolled taxpayer.

In addition the significant contractual terms and economic factors that could affect the prices or profits in the two transactions have to be compared as well as the property or services transferred in the transactions.

As it is nearly impossible to find two identical or nearly identical cases of intangible licensing comparable compensations are hardly found when establishing the compensation for a licensing agreement.

Notwithstanding this general difficulty the following methods often deliver sufficient results.

According to internal directives by the tax authorities, e.g. in Germany, the uncontrolled comparable price method, if applied to assess the appropriate licence fee between related parties, shall be executed priorily by internal comparison. The U.S. rules tend to favour internal comparables as well when compared to external comparables. Therefore, licence fees of comparable licence agreements between the licensor and unrelated licensees could be of great use. For this purpose even a joint venture between the licensor or a company of the licensor's group and a third party may qualify as "unrelated party", if the third party partner holds the majority of the voting rights or shares.

Generally, as a practical matter the limitation on access to third party data will limit the use of external comparables considerably.

Such external comparables might be found by investigations at organisations which continuously survey the economic data of a country, the different business associations

(e.g. of industry, trade, tax professionals, CPAs, lawyers), professional information bureaus and data bases.

Such data bases are often computer data bases, e.g. for the US specialized proprietary data bases which focus on the conditions of transfer of rights. These are heavily turned toward certain transactions or industries. However, access to such databases tends to be extremely expensive and the information regarding a particular transaction is limited. Standard public databases on general economic data will be largely inadequate to meet external comparable requirements. They do not contain the details required to adequately support comparability. This is particularly true since comparability in the USA now includes long-term expectations and their present value. These two subject matters are unreported and generally internally determined and specific to the third parties involved.

In case of a long-term licence contract changes in the exchange rate may result in substantial detriment for one side or the other

Furthermore tax auditors who are presently auditing the taxpayer or an affiliated company could be asked for a statement in this matter. Additionally, there may exist some formula used by the relevant tax authorities for these purposes, e.g. in Germany the so-called Knoppe-Formula refer to the chapter on Transfer Pricing - General Principles in Part C on Tax Treatment of Licensing.

3 APPROPRIATE LICENCE FEE

The value of an invention is influenced by many factors, e.g. breakthrough (pioneer) invention, significant cost-reducing improvement, scope of the right licensed, number of competitors and thus potential licensees, usual profit margins in the respective branch of industry and necessary advertising expenses, mass article or special product, expected total income of the inventor per year

and invention ready for commercialisation or a mere paper patent with high developing cost, patent for protection of other similar patents, term of the licence agreement, restriction on use, licence territory, exclusive or non-exclusive licence, exchange of experience, transfer of periodic updates or improvements to licensor, introductory training, market surveillance.

For the valuation of the right to use a patent or know-how it is of great importance whether the licence is exclusive or non-exclusive.

An exclusive licence transfers the monopolistic status of the licensor to the licensee, who can supply a certain market, e.g. a whole country, without competition by the licensed product. This exclusivity will be reflected in a higher licence fee, as profits out of the licensed production are easier expected than in case of a non-exclusive licence. This will be especially true where the invention places the licensed product far ahead from other products for similar purposes.

A non-exclusive licence on the contrary is not as valuable, thus the licence fee for the same patent or know-how should be lower than in case of an exclusive licence, especially if the licensing agreement contains geographic limitations for the licensee, e.g. distribution only in a restricted region.

Furthermore the uniqueness of the property and the period for which it remains unique is relevant, including the degree and duration of protection afforded to the intellectual property under the laws of the relevant countries.

With regard to standard computer software or other know-how, which are out of date relatively fast, higher licence fees, e.g. up to 20 % - 30 % of the factory sales price, shall widely be found in practice.

The factors to be considered in the valuation of an intangible include the duration of the licence, contract, or other agreement, and any termination or renegotiation rights, any economic and product liability risks to be as-

sumed by the licensee, the existence and extent of any collateral transactions or ongoing business relationships between the licensee and the licensor and the functions to be performed by the licensor and licensee, including any ancillary or subsidiary services. Additionally the concrete negotiating circumstances will be important, e.g. whether the licensor is an individual inventor who cannot set up the production of his invented product himself or an international corporation which could produce the product itself, if no acceptable licence agreement can be found.

A licensor to a licensing agreement with an unrelated licensee may reasonably consider in his calculation of the fee his costs for research and development of the intangible property until production maturity of the product concerned as well as the theoretical profit he would be able to realise, if the product to be licensed would be produced and distributed by himself instead of the licensee.

According to the German Administrative Principles a licensee to a licensing agreement with an unrelated licensor calculates the licence fee which he is willing to accept on the basis of his theoretical profit out of the manufacturing and distributing process of the licensed product and under consideration of all payments which are required by the licensor under the licensing agreement. Naturally, both parties will try to achieve an acceptable profit.

Licensing agreements between related parties should establish a compensation which is "appropriate". The relating transfer price issues will be discussed in the chapter on Transfer Pricing - General Principles in Part C on Tax Treatment of Licensing.

CURRENCY ISSUES

In case of a long-term licence contract changes in the exchange rate may result in substantial detriment for one side or the other. Therefore, often a conversion rate clause on a certain fixed date is integrated into the licensing agreement. The institute whose conversion rate shall be applied should be explicitly stated in the contract.

The licensee can make sure that the contractual exchange rate will be applied, if he timely reports and pays the licence fees.

Another method to secure the agreement against currency change is an arrangement, which relates the licence fee to a more stable foreign currency. In some countries it may be necessary to get the prior approval of the State Bank to such a clause.

As currency changes can turn the agreement for both parties unattractive, a clause providing for an adjustment or an extraordinary termination of the contract is advisable.

In case of related parties where licensor and licensee are located in different countries with an unstable exchange rate tax auditors may closely scrutinize the licence fee clause whether or not the currency risk is burdened to only one party. An arm's length licence fee clause would have to provide for a ceiling concerning the currency risk for both parties.

For example in case of a hypothetical German tyre production and distribution subsidiary of a US-licensor the licence fee clause of the licensing agreement for the trademark under which the tyres are produced and distributed may provide for a general licence fee of 4,00 % of the net sales in German Marks. As shown by the figures beneath such an agreement would benefit the US-licensor in case of a decreasing Dollar exchange value and disadvantage him in case of increasing exchange value, since he receives the royalties in DM.

Therefore, in practice an additional clause has been agreed upon which provides for a minimum royalty of US-\$2,00 per 1 tyre sold. Here the currency risk is with the licensee as he has to transfer US\$.

A combination of both clauses, which has been found in practice, would limit a decrease of royalty receipts in case of a falling US-\$ and allow extraordinary profits in case of a climbing US-\$.

To avoid this unilateral benefits out of exchange alteration two additional clauses in favour of the licensee provide for a well-balanced apportionment of the currency risk. The first provision limits the royalty payments to a certain amount in US-\$ per 1 tyre, e.g. 4\$/1 tyre. The second clause provides for an additional ceiling in the amount of a certain percentage of net sales in DM, e.g. 5%. The figures below show

the impact the various exchange rates have on the royalty payments and how the limits operate. The example is based on net sales proceeds of DM 100/1 tyre in case of export and DM 150/1 tyre out of domestic sales.

Furthermore, the parties may use the possibility of hedging to cover their currency risks by buying and selling simultaneously the required currency in the financial futures market.

Additionally, the detrimental effects of inflation have to be considered in a licensing agreement. In case of a turnover related licence fee (sales royalty) the inflation risk will generally be covered, unless the sales prices are regulated by the government concerned. If an unit related licence fee (unit royalty) is given, the risk of inflation has to be taken into account, e.g. by a value guarantee clause, which may in certain countries need the prior approval of the State Bank.

COST SHARING AND COST FUNDING

Research and development (R+D) being an ongoing process, cost sharing produces payments for the developer from the beginning of the research project. Usually cost sharing payments would not exceed royalty payments for developed intangibles. However, in case of an unsuccessful R+D effort cost sharing payments would by far exceed the arm's length purchase price or royalty.

For a detailed comparison between licensing and cost sharing please refer to chapter on General Introduction-Licensing versus cost sharing in Part A as well as to the chapter on Introduction-The Trade Off between licensing and cost sharing agreement in Part D, hereafter and the separate transfer pricing product.

IN THE FOLLOWING ISSUES:

Part C: Tax Treatment of Licensing
June 1995 issue

Part D: Tax Planning Considerations, Opportunities and Pitfalls
December 1995 issue

CURRENCY RISK LIMITATION

Conditions:

1 tyre export	DM	100.00
1 tyre domestic	DM	150.00

Exchange Rate	Place of Destination	4,00 % (in DM)	\$ 2,00 / 1 tyre (in DM)	\$ 4,00 / 1 tyre (in DM)	5,00 % (in DM)
1\$ = 1,00 D	domestic	6,00 DM	2,00 DM	4,00 DM	7,50 DM
	export	4,00 DM	2,00 DM	4,00 DM	5,00 DM
1\$ = 1,50 DM	domestic	6,00 DM	3,00 DM	6,00 DM	7,50 DM
	export	4,00 DM	3,00 DM	6,00 DM	5,00 DM
1\$ = 2,00 DM	domestic	6,00 DM	4,00 DM	8,00 DM	7,50 DM
	export	4,00 DM	4,00 DM	8,00 DM	5,00 DM
1\$ = 2,50 DM	domestic	6,00 DM	5,00 DM	10,00 DM	7,50 DM
	export	4,00 DM	5,00 DM	10,00 DM	5,00 DM
1\$ = 3,00 DM	domestic	6,00 DM	6,00 DM	12,00 DM	7,50 DM
	export	4,00 DM	6,00 DM	12,00 DM	5,00 DM
1\$ = 3,50 DM	domestic	6,00 DM	7,00 DM	14,00 DM	7,50 DM
	export	4,00 DM	7,00 DM	14,00 DM	5,00 DM
1\$ = 4,00 DM	domestic	6,00 DM	8,00 DM	16,00 DM	7,50 DM
	export	4,00 DM	8,00 DM	16,00 DM	5,00 DM*

* In case of extreme exchange rate alterations re-negotiations of the minimum and maximum limit should be provided for by the license agreement.

Q U O T E

Consider that
people are like
tea bags,
they don't know
their own
strength
until they
get into
hot water

Dan McKinnon

E R R A T A

In our article on 'What's New in the 1995 Budget' on page 5, of the December 1994 issue, we apologise that there are some errors in the table provided. The correct table is republished accordingly.

RATES OF INCOME TAX FOR THE LAST 4 YEARS

CHARGEABLE INCOME		RATE OF TAX			TAX PAYABLE (CUMULATIVE)		
BAND	TOTAL	1995	1993	1992	1995	1993	1992
RM	RM	%	%	%	RM	RM	RM
Resident individuals							
2500	2500	0	2	4	0	50	100
2500	5000	3	5	7	75	175	275
5000	10000	6	8	10	375	575	775
10000	20000	7	10	12	1075	1575	1975
15000	35000	12	15	17	2875	3825	4525
15000	50000	18	21	22	5575	6975	7825
20000	70000	23	26	27	10175	12175	13225
30000	100000	28	31	32	18575	21475	22825
50000	150000	31	34	35	34075	38475	40325
excess		32	34	35			
Cooperatives							
10000	10000	1	2	4	100	200	400
10000	20000	3	4	6	400	600	1000
10000	30000	6	7	9	1000	1300	1900
10000	40000	9	10	12	1900	2300	3100
10000	50000	12	13	15	3100	3600	4600
25000	75000	16	17	19	7100	7850	9350
25000	100000	20	22	23	12000	13350	15100
50000	150000	24	26	27	24100	26350	28600
100000	250000	27	29	30	51100	55350	58600
250000	500000	30	32	33	126102	135350	141100
excess		32	34	35			

New Development at the Stamp Duty Office

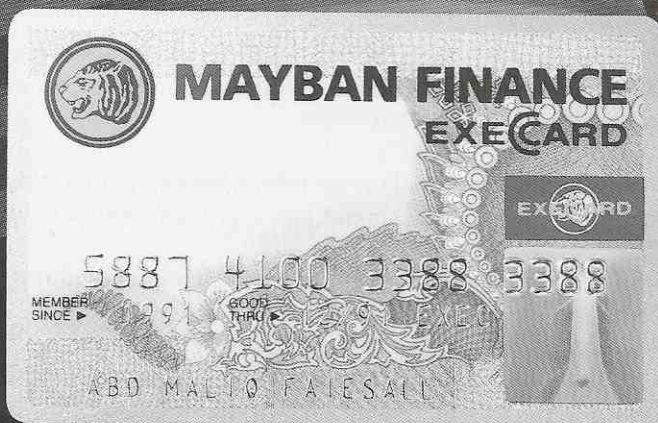
In our December 1994 issue on the above article, we referred to Mr Ong Kok San as the acting Collector of Stamp Duty. It has been brought to our attention that Mr Ong Kok San's correct designation is the Deputy Collector of Stamp Duty. We apologise for the error made and any inconvenience or embarrassment caused is deeply regretted.

The first line of the second paragraph of the article therefore should read as follows:-

"On October 25, 1994 the representatives of the Institute met with the Deputy Collector of Stamp Duty, Mr Ong Kok San to discuss the new development in the valuation of shares for stamp duty assessment."

FROM THE PREMIER FINANCE COMPANY E X E C C A R D

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Batu Pahat
Tel: 07-44255, 44277

Johor Bahru
Tel: 07-235214

Jalan Tebrau
Tel: 07-339964, 339993

Kluang
Tel: 07-722311, 724209

Muar
Tel: 06-913818, 913816

Segamat
Tel: 07-913502

KEDAH DARUL AMAN
Alor Star
Tel: 04-719959, 719982

Sungai Petani
Tel: 04-429111, 429112

Langkawi
Tel: 04-789077, 789248

KELANTAN DARUL NAIM
Kota Bharu
Tel: 09-782861, 746558, 784688, 784985

MELAKA
Tel: 06-238922

NEGERI SEMBILAN DARUL KHUSUS
Seremban
Tel: 06-725642, 731050

PAHANG DARUL MAKMUR
Kuantan
Tel: 09-522880, 524284

Mentakab
Tel: 09-273572

PERAK DARUL RIDZUAN
Ipoh
Tel: 05-510387, 535155, 536819, 537636

Kampar
Tel: 05-653791

Kamunting
Tel: 05-828091, 828092

PERLIS
Kangar
Tel: 04-765663

PULAU PINANG
Butterworth
Tel: 04-312414

Pulau Pinang
Tel: 04-624505, 626934

SABAH
Kota Kinabalu
Tel: 088-245000, 245500

Sandakan
Tel: 089-43548, 43549

Tawau
Tel: 089-777706, 777362

Lahad Datu
Tel: 089-81143, 81144

SARAWAK
 Bintulu
Tel: 086-35629

Kuching
Tel: 082-259691, 259891, 256140

Miri
Tel: 085-410996

Sibu
Tel: 084-316000, 316001, 316002

SELANGOR DARUL EHSAN
Damansara Jaya
Tel: 03-7197276, 7197277

Klang
Tel: 03-3414911, 3414933

Petaling Jaya
Tel: 03-7576155, 7576172, 7576186

Shah Alam
Tel: 03-5593277, 5504107

Subang Jaya
Tel: 03-7344880, 7344884

Kajang
Tel: 03-8367994, 8367548

TERENGGANU DARUL IMAN
Kemaman
Tel: 09-593285

Kuala Terengganu
Tel: 09-624776, 624899

WILAYAH PERSEKUTUAN
Jalan Kelang Lama
Tel: 03-78143778

Jalan Pudu
Tel: 03-2223219, 2222320, 2222321

Medan Pasar
Tel: 03-2387522, 2382714, 2304731, 2304730

Medan Tuanku
Tel: 03-2931311, 2931395

Salak South
Tel: 03-7812898, 7812899

Setapak
Tel: 03-4220922, 4219067



MAYBAN FINANCE BERHAD
We've Got The Time For You

Procedures For Application For Approved Research Under Section 34A, Income Tax Act, 1967

- (1) Application should be made in accordance with the attached format in 8 copies and submitted to:-

Director-General
Malaysian Industrial Development Authority (MIDA)
4th Floor, Wisma Damansara
Jalan Semantan, P.O. Box 10618
50720 Kuala Lumpur

- (2) Application should be submitted within six (6) months from the end of the financial year in which the R & D expenditure was incurred.
- (3) For proposed research projects, applications should provide an estimate of the expenditure for each item.
- (4) Appeals with regard to applications rejected by the Ministry of Finance must be made within 2 months from the receipt of official letter from the Ministry. Appeals received later than the above mentioned period will not be considered.
- (5) All applications and appeals will be acknowledged within two weeks of receipt. If acknowledgement is not received, please contact MIDA at:

Telephone No: 03-2553633
Fax No: 03-2557970

- (6) The guidelines for application are attached as Appendix.

Appendix

GUIDELINES

1. Criteria for Eligibility

- (a) The definition of research for the purpose of this application is as follows:

"Research means any systematic or intensive study carried out in the field of science or technology with the object of using the results of the study for the production or improvement of materials, devices, products, produce or processes but does not include:

- (i) quality control of products or routine testing of materials, devices, products or produce,

- (ii) research in the social sciences or the humanities;
- (iii) routine data collections;
- (iv) efficiency surveys or management studies; and
- (v) market research or sales promotion".

- (b) The research undertaken must be in accordance with the needs of the country and bring benefit to the Malaysian economy.
- (c) Foreign researchers may be employed. The company should, however, endeavour to train Malaysians.
- (d) Proposed research projects will also be given consideration.

2. Guidelines on Allowable Expenditure

The following expenditure can be considered for double deduction:

- (a) Raw materials used directly in the research project.
- (b) Technical services undertaken in Malaysia which include payments such as:
- (i) Consultancy fee for obtaining information / advice pertaining to the research being undertaken.
- (ii) Payment for use of testing equipment, analytical services and data evaluation.
- (c) (i) Travelling cost related to visiting research stations. Allowable expenditure include the travelling cost, food and lodging expenses. The maximum allowable expenditure for food and lodging is RM400 per person per day.
- (ii) Travelling cost related to attending courses / seminars locally or overseas. Allowable expenditure include the travelling cost, course / seminar fee and food and lodging expenses. The maximum allowable expenditure for food and lodging is RM400 per person per day. In the case of air travel, only economy class rate will be allowed.

- (d) (i) Cost of transporting materials used in the research.
- (ii) Direct cost on maintenance of vehicles used in the research.
- (e) Basic salary of staff involved directly in the research project. The salary that can be claimed should reflect the amount of time the personnel devote to the particular research project.
- (f) Rental of equipment/machinery/buildings used for research.
- (g) Maintenance of buildings used for research.
- (h) Maintenance of machinery and equipment used for research.

Capital expenditure on buildings, machinery and equipment used in research are not eligible for double deduction claim as these would qualify for Investment Tax Allowance.

FORMS

PART I : PARTICULARS OF COMPANY

1. Name of Company: _____
2. Address of Registered Office:
Telephone No: _____
Fax No: _____
3. Address of Factory: _____
Telephone No: _____
Fax No: _____
4. Date of Establishment of Company: _____
5. Income Tax File No. and Branch: _____
6. Financing
 - (a) Authorised Capital (RM): _____
 - (b) Paid-Up Capital (RM): _____
 - (c) Loan (RM): _____

7. Equity Structure:

- (a) Malaysian: _____
- (b) Foreign (Specify country): _____

8. Types of Incentives Approved Under Promotion of Investment Act, 1986 and Date Approved: _____

9. Types of Products: _____

10. Sales Turnover For Past Two Years: _____

PART II : RESEARCH PROJECTS

1. List down the research projects applied for approval

Title of Project	Date of Commencement	Date of Completion

2. Research period applied for approval.

3. List down the research projects and the amount of expenditure for double deduction approved by Ministry of Finance in the past.

PART III : PARTICULARS OF RESEARCH PROJECTS

For every project listed in question (1) of Part II above, please give the required information as follows:

1. Title of Project.
2. Background of research (please state the reasons for the undertaking such research).
3. Location where research is carried out.

If any part of the research is contracted out or undertaken as a joint-venture project with another company/organization, state the name, address and country of origin of the company/organization and details of research.

If research is undertaken overseas, please state reasons.

4. Objectives of research project.

5. Methodology

Schedule of research activities

Method and technique

6. Testing/investigation carried out.

List down the testing/investigation carried out and equipments/tools used for this purpose:

Testing/Investigation carried out

Equipment/tools used

7. Results of Research:

For completed projects, please explain in detail the results of the research.

For continuing research projects, please explain progress and achievement in the projects with relevant photographs emphasizing on how much of the objectives of the research have been met.

For research projects proposed to be undertaken, please explain the anticipated results of the research.

8. Expenditure on Research-Project

(a) Raw Materials

Name of Material	Usage in Research	Expenditure (RM)

Total

(b) Manpower in Research Project*

Name of Officer/ Staff**	Citizenship	Post Held	Qualifications and Experience	Job Responsibility	Basic Salary (RM)	Percentage of Time Allocated for Research	Basic Salary for Research (RM)

* Please attach an organisation chart of the company and indicate the posts held by the research staff.

Total Basic Salary for Research

** For each officer / staff, attach a copy of employers notification (EA form) sent to Inland Revenue Department.

CIRCULAR



(c) Technical Services (e.g. testing, data analysis, etc.)

Type of Technical Services Obtained	Relevance of Technical Services to Research Projects	Agency/ Individual Which Provides the Technical Services	Location Where Services Was Carried Out (Local/Overseas)	Expenditure (RM)

Total _____

(d) Travelling Cost and Expenditure

(i) Travelling related to visiting research stations:

Date and Duration of Visit	Place	Purpose	Names of Officers Who Visited the Research Station	Travelling Cost (RM)	Food and Lodging Expenditure (RM)

Total _____

(ii) Travelling related to attending courses/seminars:

Date and Duration of Courses/ Seminars	Title	Names of Officers Who Attended the Courses/ Seminars	Venue	Organizer	Course/ Seminar Content	Travelling Cost (RM)	Course/ Seminar Fee (RM)	Food and Lodging Expenditure (RM)

Total _____

(e) Transportation Cost

(i) Cost of transporting materials used in the research:

Name of Material	Usage in Research	Destination		Expenditure (RM)
		From	To	

Total _____

(ii) Direct cost on maintenance of vehicles used in the research:*

Vehicles Used in R & D	Usage of Vehicles in Research	Maintenance Carried Out	Expenditure (RM)

Total _____

* For agriculture-based research only.

(f) Maintenance of Building:

Types of Building Used in Research	Relevance of Building in Research	Details on Maintenance Carried Out	Expenditure (RM)

Total _____

(g) Maintenance of Equipment:

Types of Building Used in Research	Relevance of Equipment/Machinery in Research	Details on Maintenance Carried Out	Expenditure (RM)

Total _____

(h) Rental of Equipment/Machinery/Buildings

Types of Equipment/ Machinery/Building	Usage of Equipment/ Machinery/Building in Research	Rental Expenditure (RM)

Total _____

Grand Total _____

PART IV: DECLARATION

CERTIFICATION

I hereby certify that all the particulars furnished in this application are true and correct.

Signature of Applicant

Name in Block Letters

Date: _____

Designation in Company

Certification by the External Auditor (For Expenditure Already Incurred)

I/We have examined the expenditure set out in the above Application for Approved Research and confirm that the expenditure is in accordance with the accounting books and records of the company which formed the basis of the company's audited accounts for the year/period ended _____

Signature

Name of Certified External Auditor

Approval No.

Date: _____

Name and Address of Audit Firm

Q U O T E

**The secret of patience:
do something else
in the meantime**

- Anonymous -

E R R A T A

In our articles on 'Real Property Gains Tax' on page 33 of the December 1994 issue, we apologise that there are some errors in the tables provided. The correct tables are republished accordingly.

EXAMPLE 4

Encik Ismail had 40,000 shares in ABC Sdn Bhd. initially deemed to be acquired on 21st October 1988 for:

$$40,000 \times \text{RM}1,200,000 = \text{RM}240,000 \text{ of RM6 per share}$$

$$\underline{200,000}$$

His chargeable gain on the 1st April 1989 disposal is;

Sale proceeds	150,000
less: Acquisition price 10,000 x RM6	60,000
	<u>90,000</u>

Subject to any exemptions or relief tax will be charged at 20%, that is the rate appropriate for less than 2 years of ownership.

From 1st May 1989, he is deemed to have acquired the balance of his shares at that date for a consideration of:

$$30,000 \times \text{RM}3,000,000 = \text{RM}450,000 \text{ or RM15 per share}$$

$$\underline{200,000}$$

His chargeable gain on the 1st August 1989 disposal is;

Sale proceeds	210,000
less: Acquisition price 12,000 x RM15	180,000
	<u>30,000</u>

Subject to any exemptions or relief tax will be again be charged at 20%.

His chargeable gain on the 1st April 1993 disposal is;

Sale proceeds	750,000
less: Acquisition price 72,000 x RM15	270,000
	<u>4</u>
	<u>580,000</u>

Subject to any exemptions or relief tax will be charged at 10% (within 4 years of acquisition).

RATES OF TAX

For a disposal within the following period after acquisition:

	%
First and second years	20
Third year	15
Fourth year	10
Fifth year	5
Thereafter	
Companies	5
Others	0

THIRD MIT AGM

**Members are informed that the
Institutes's Third Annual General
Meeting will be held at
10.00 am on Saturday
8th April 1995**

MEMORANDUM

for Annual dialogue with the Director General of Inland Revenue

The Malaysian Institute of Accountants and the Malaysian Institute of Taxation would like to raise the following matters for discussion at the Annual Dialogue with the Director General of Inland Revenue:-

1. INSTALMENT PAYMENT SCHEME (SECTION 107B)

Under the Income Tax (Deduction from Remuneration) Rules 1994, it is mandatory for an employer to deduct monthly deduction on account of tax from the remuneration of each of his employees.

However, where a taxpayer has non-employment income (e.g. business, rent, etc.) besides employment income, notice of payment by instalments (CP38SA) under Section 107B(1) Income Tax Act 1967 (the Act) would also be issued to the taxpayer to pay tax by bi-monthly instalments in respect of his non-employment income.

Section 107B(2) of the Act allows a taxpayer to vary the amount to be paid by instalments and the number of instalments. However, section 107B(4) states that where the proviso to subsection (2) applies and the tax payable under an assessment exceeds the total of the instalments payable, a penalty of 10% is imposed on the amount in excess of 30% of the difference between the tax payable and the instalment payments.

In the above situation, if an application to vary the amount to be paid by instalments is granted, any penalty to be imposed on the amount in excess of the 30% should be based on the total instalment payments under Section 107B(2) as compared with the portion of the tax payable on the non-employment income for the year of assessment and not on the full tax payable for the year of assessment.

We would like to have IRD's confirmation that the above is correct.

2. SECTION 107A(1)(b) DEDUCTIONS

The 5% deduction of the service portion of the contract payments made to non-resident contractors was introduced to ensure that foreign employees of non-resident contractors pay their tax before leaving the country. It is a deposit on account of the employees' tax and is to be refunded by the Director General to the non-resident contractors.

However, the present conditions imposed by the Collection Branch of the IRD before a waiver can be granted or refund made of the 5% withholding tax should be reviewed.

The particulars to be furnished are as follows:-

- (i) The income tax reference number of every employee of the non-resident contractor.
- (ii) The total remuneration of every employee, foreign as well as local employee for each year.
- (iii) The grand total of the above remuneration.
- (iv) Reconciliation of the remuneration in (iii) above against the amount charged in the accounts of the business carried on by the non-resident contractor if the accounts of the business of the non-resident contractor ends on a day other than 31 December.
- (v) Clearance letters for every foreign employee who has left Malaysia and copy of the payment receipt.
- (vi) Details of payment under Section 107A(1)(b) which are still held by the Department.

We feel that some of the conditions imposed are too demanding because:-

- (i) Not all local employees are liable to tax. As such, they will not have tax files and it would be pointless to register income tax files.
- (ii) Reconciliation of the remuneration paid against the amount charged is generally impossible as remuneration of an employee can be charged under various contract projects and various accounts (e.g. P&L account, work in progress).
- (iii) Payment receipts are issued by the IRD and thus there is no way of submitting them especially if the employee has ceased employment.
- (iv) Details of payments under Section 107A(1)(b) are available with the Collection Branch of the IRD.

We would suggest that the matter be resolved as follows:-

- (i) In respect of deductions already made under Section 107A(1)(b), a refund should be authorised if a copy of the latest Form E (excluding Forms CP 8A) is submitted to the Collections Branch and the Non-Resident Branch. (This effectively furnishes the total remuneration payable to employees both local and foreign).
- (ii) In respect of deductions in 1995 and future years, it is suggested that, with the implementation of the Schedular Tax Deductions, waiver from the deduction under Section 107A(1)(b) should be granted on application by the non-resident contractors concerned and that the IRD should issue a direction to the payer readily.

3. NON-TAXABILITY OF FOREIGN INCOME REMITTED BY RESIDENT COMPANIES UNDER SECTION 3C OF THE INCOME TAX ACT, 1967

(i) Dividend payments

Since the income remitted from overseas by resident companies is exempt from income tax, these income cannot be paid as dividends to shareholders without incurring a charge as there is no Section 108 credit against which dividends can be franked. During the IROU seminar in November 1994, the participants were informed that the law will be amended so as to enable the exempt income to be paid out as exempt dividends.

When will the amendments be made? It is necessary that the amendments be made as soon as possible because many resident companies are hesitating to remit income from offshore as they are uncertain as to the treatment of dividends paid to shareholders.

(ii) Approved overseas investments

In the 1994 Budget, it was proposed that the threshold of foreign income remitted to Malaysia which is exempt from tax will be increased from 50% to 70. However, it is understood that the legislation relating to this incentive has not been gazetted.

The Institute would like to seek IRD's clarification if this incentive is still in place and available to potential investors or whether it is overridden by the provision under Section 3C.

4. REVIEW OF THE TAX CHECKLIST ISSUED BY IRD ON 10 APRIL 1991

We refer to your Checklist on Income Tax Computations issued on 10 April 1990. The Institute supports the IRD's effort to increase tax awareness amongst the public and have disseminated the checklist to our members.

To facilitate higher degree of compliance with the Checklist, the Institute would like to present below suggestions in respect of some of the items requested in the Checklist. The comments refer to Part B (Additional Particulars) of the Checklist.

(i) Overseas trips

The information requested could be limited to only overseas trips and to directors. For employees, the Institute suggests that information be furnished only in respect of trips exceeding say RM5,000 per trip.

(iii) Head office Expenses Housing Development

Guidelines or practice notes issued by the IRD similar to the ones issued on Section 33(2) interest restriction will provide the taxpayer with some certainty on the tax treatment of same items.

The Institute would like to propose the following so as to assist in improving compliance:-

i) The IRD should have more dialogues and briefing sessions with members of the professional bodies such as MIT. Feedback received during such sessions may be effective in increasing awareness of taxpayers responsibilities.

ii) The IRD should consider issuing more guidelines on specific issues where there is certainty and uniformity of tax treatment of such issues which have been contentious in the past as this would expedite agreement to assessments.

5. LATE RECEIPT/NON RECEIPT OF NOTICE OF ASSESSMENT

Notice of Assessment and Additional Assessment (Borang J and JA) are sent by ordinary mail to taxpayers and it appears to be the Inland Revenue Department's policy that a notice is deemed received by the taxpayer as long as it was correctly addressed and

it has not been returned by the post office. This is in accordance with the provisions of Section 145 of the Income Tax Act 1967. There are cases where such notices (for unknown reasons) do not reach the taxpayer or his agent. One possible explanation is that certain persons do not bother to return to the post office any mail which has been wrongly delivered. There are many documented cases of such wrong delivery of mail.

It is felt that the Inland Revenue should accept representations made by the taxpayers who have actually not received the notice of assessment, and where the representation is substantiated, the tax payer should not be penalised for a matter not of his own making. Penalties arising from the late receipt/non-receipt of notices of assessment represents great injustice to the taxpayers.

We hold the view that no penalties should be imposed in such circumstances.

6. EXTENSION OF TIME FOR FILING RETURNS

We appreciate the IRD's objective to improve the overall level of compliance in the filing of returns and every effort would be made to comply with the filing programme. However, we would like to urge the DGIR to consider allowing companies having December financial year ends automatic extension of time for filing returns to August 31. This is in view of the fact that most companies have their financial year ends at December 31. A reasonable period of time must be allowed for the companies to finalise their accounts and for tax computations to be prepared. Also with bi-monthly instalment payments and Schedular Tax Deduction (STD) scheme in place, IRD should consider granting this extension.

7. INTEREST RESTRICTION (SECTION 33(2))

The IRD Guidelines on interest restriction, issued in 1990, state that where interest on borrowed money charged to the business accounts does not exceed RM10,000 in the case of companies and RM6,000 in the case

of individuals and others, Section 33(2) restriction will not be applied and the full interest will be allowed against the business income.

A member has brought to our notice that the Assessment Branch in Kedah had disallowed bank overdraft interest of less than RM10,000 to a company by application of Section 33(2) (c) because the investment balance exceeded bank overdraft. The Assessment Branch had stated that the IRD guidelines are not necessarily to be applied in every case.

We seek a clarification on the IRD's position.

Also there have been variations in the restriction of interest expense under Section 33 (2) by IRD.

Certain branches have classified investments into income-producing and non-income producing for purposes of setting of interest whilst certain branches have treated each investment as a separate source and interest is allowed only against income derived from each source.

We trust that the guidelines will be implemented on a nationwide basis.

8. LATE PAYMENT PENALTIES UNDER SECTION 107B AND SECTION 103

Our member has expressed concern that his client was subject to late payment penalty under both Section 107B and Section 103.

The details of the case are as follows:-

The client was subject to the bimonthly instalment payments under Section 107B for Year of Assessment 1993. He failed to settle the difference of RM60,000 between the tax payable as per the Form J for Year of Assessment 1993 and the total amount payable under Section 107B within 30 days from the last instalment i.e. 30.11.1993. The difference was paid the following month.

Recently the IRD issued a notification demanding a total of RM12,000 comprising the following:-

(i) Late payment penalty for last instalment under Section 107B	RM 6,000
(ii) Late payment penalty for failure to settle the tax in full before 1.12.1993 under Section 103	6,000
	<u>12,000</u>

The member has written to IRD explaining that since the Year of Assessment 1993 tax was already subject to Section 107B and not Section 103, any late payment penalty should hence be raised under Section 107B and not Section 103. Further, the penalties were imposed on the same late payment offence and for exactly the same period. The IRD had rejected their explanation and verbally informed that they had been imposing such double penalties since the said Section was first introduced a few years ago.

This is unjust and we propose that the law be suitably amended to avoid double penalties on the same offence.

9. TAX PAYMENTS

It will be helpful if it is implemented nationwide for Income Tax Branch Offices or appointed Local Banks to accept payments of income tax (especially STD payments) and the date of payment should be the date when such payments are made to the local branches/banks.

In line with the procedures for Sales Tax and Service Tax, we propose that the remittance for STD be made bimonthly.

We also note that Statements of Tax Payments now issued by the Department yearly show only tax payments. We propose that income tax, etc. charged should also be included (similar to Creditors Statements, Bank Statements, etc.) so that taxpayers are informed whether or not there is tax unpaid or in credit.

In situations where the 1994 income is paid in 1995, the IRD should set up procedures whereby taxpayers are not forced to make double payments of tax for the same income.

10. REPAYMENTS

We note that taxpayers are penalised when income tax payments are not made within 30 days or extensions of time allowed, if any. However, when repayments to taxpayers are not made within a reasonable time, taxpayers have to bear the loss of either interest or other opportunity costs.

This is inequitable and Government should consider compensating taxpayers where such losses occur due to delays by the IRD in making refunds in repayment cases. The losses suffered can be considerable especially in cases of appeal involving material amounts where taxpayers are forced to pay first, whatever the grounds of appeal, and such payments are tied up with the Department over a considerable period of time.

For a start, a taxpayer should not make STD payments when there is substantial repayment due to the taxpayer by the IRD.

11. SEPARATE ASSESSMENT FORM FOR WIFE

Practical difficulties have been encountered by married individuals in completing the assessment form as information on the wife may not be available, particularly in cases where the couple have separated temporarily or where the wife does not wish to disclose information on details of her earnings to her husband.

It is suggested that to avoid unnecessary delay in filling the return forms, a separate assessment form should be issued to the wife upon specific requests or a method whereby the wife should be able to submit the details of her income separately to the IRD.

12. STANDARD TAX DEDUCTION (STD)

We would like to seek clarification and confirmation on the following problems currently faced by employers in complying with the STD:

- For non-residents who are employed in Malaysia for a period or periods not exceeding 60 days in a calendar year, they are ex-

empt under Paragraph 21, Schedule 6 of the Income Tax Act, 1967. Hence, they should not be subject to the STD. Please confirm. If the STD needs to be complied, is there any relaxation on this? This is because for expatriates engaged in the oil and gas industry, they may enter and leave Malaysia every 30 days. Some of them may stay in Malaysia for more than 60 days but there may be some who may never come back. It would not be fair for this category of expatriates to pay tax upfront when they are not subject to tax in the first place.

- b) Directors' fees are usually paid once a year upon confirmation during the Annual General Meeting of the company. It is understood that such directors' fees are subject to the STD. Please confirm that the STD on directors' fees are similar to that used for bonus and other lump sum payments.
- c) In the notes to the Income Tax (Deduction From Remuneration) Rules 1994, it is explained that EPF of not exceeding RM416 per month should be deducted from the monthly remuneration to determine the STD. However, for bonus which is subject to EPF, there is no indication that EPF thereon should also be deducted for STD purposes.

Please confirm that EPF should also be deducted from bonus to determine the STD provided that the amount to be deducted shall not exceed RM5,000 and the amount of EPF attributable to the remuneration for the 12 months of the relevant year of assessment.

- d) It is common for expatriates of a foreign company to be sent to Malaysia to render technical services to a local company. Their salaries are paid by the foreign company in the home country and the local company pays technical fees to the foreign company for services rendered.

These expatriates are taxable in Malaysia for having or exercising an employment in Malaysia. However, the local company is not the employer of the expatriates who are employees of the foreign company. Is the local company the deemed employer of the expatriates such that they are required to comply with the STD?

In practice, it would be impossible for the local company to comply with the STD because firstly, as the expatriates are not their employees, they do not have control of the salaries payable to the expatriates and therefore have no funds from which the tax can be deducted. Secondly, the local company would not know the monthly remuneration paid in the foreign country.

Thirdly, the local company would not know whether the expatriate concerned is single or married, whether his wife is working, the number of children qualifying for child relief, etc to determine the amount of the STD.

- e) Many companies employ casual workers who are paid daily or weekly and whose wages, when accumulated for the month, is within the taxable range. They are technically employees and therefore would be subject to the STD. However, in practice, it is impossible to comply because these workers may not return to work after drawing their last wages such that by the end of the month, there are no sums payable to them from which tax can be deducted. Please confirm that the STD need not be complied for this category of workers. If the STD needs to be complied, please confirm that the IRD will not be strict towards employers engaging these workers.
- f) There are certain employees who do not receive a fixed salary per month but have fluctuating salaries, i.e., in some months they may receive a salary of RM1,000 a month while in good months, they may receive a salary of

RM6,000 a month. A bonus may be paid by the employer in any of the months. Which month's salary is to be used to determine the monthly remuneration for the purposes of determining the STD on the bonus?

- g) It is our understanding that refunds due to over-deduction will be effected within one month. Will the refunds be automatic or will the taxpayer have to request for a refund? Since the IRD imposes penalties for late payment of taxes, interest for late refunds to taxpayers should be considered.
- h) The onus of complying with the STD lies with employers. In many instances, they have to take the role as tax consultants to ascertain whether a particular payment made to its employees are taxable to them in the first place before determining the STD. There may be cases where employers erroneously subject certain payments to employees to the STD resulting in financial hardship to the employees. e.g. a retirement gratuity paid to an employee upon reaching the age of 55 years and having served the company for more than 10 years is exempt under Paragraph 25, Schedule 6 of the Income Tax Act, 1967. However, the employer may erroneously subject such a payment to the STD when it is exempt in the first place. If the employee is in need of the gratuity for certain purposes, the net amount received would substantially be reduced by the STD.
- i) With the implementation of the STD, taxes are remitted directly by the employer to the IRD in respect of taxes payable by its employees. In relation to withholding tax under Section 107A(1)(b) of the Income Tax Act, 1967, the IRD should readily grant a waiver of the 5% withholding if the non-resident contractor can substantiate by way of Form CP 39 that his em-

1995 Programme For Filing Returns Forms

1. Application for extension of time to file Return Forms after 31.5.1995 should be made by or before 15.4.1995. Staggered filing of Return Forms after 31.5.1995 will be considered in the following cases:-

For C and OG Cases

Extension of time for submission of returns will be considered up to the end of August but the programme for submission should be such that 35 percent of the returns will be submitted by end of June, another 35 percent in July and the remaining 30 percent in August. This programme must be strictly adhered to. Request for changes to the programme will not be considered.

For extension to be granted, the following conditions have to be met:-

- (a) One programme listing cases and dates of filing must

be submitted in duplicate for approval. Separate lists should be prepared for C and OG cases and the cases listed in numerical order and are to be sent to the respective Branches.

- (b) A separate application must be made for each case.
- (c) (i) In a C or an OG case where a Notice of Instalment Payment has been issued by the Department under Section 107B of the Income Tax Act 1967, an estimate of the chargeable income need not be given.
(ii) Where a Notice of Instalment Payment has not been issued, then an estimate of the chargeable income (total income in the case of individuals) should be given. The estimate of the tax is also to be com-

puted and arrangements must be made to make payments on account of tax in not more than 5 instalments, the final instalment to be made not later than October 1995. If the original estimate is subsequently found to be grossly inadequate, a revised estimate must reach the Branch Office not later than 3 weeks before the extended date of filing. Appropriate adjustments must be made to the instalment payments on account of tax.

For SG Cases

Extension of time for submission of Return Forms B and Return Forms BE up to July will be allowed, if at the time of application, payment of tax is already being made by deduction through the employer. The extension will be granted on the condition that:-

- (a) a programme listing cases and dates of filing must be submitted for approval. Separate lists should be prepared for Returns Band BE and the cases listed in numerical order; and
 - (b) A separate application must be made for each case certifying that payment of tax has been made by deduction through the employer.
2. Extension of time after July for SG cases and August for OG and C cases will not be allowed, except in cases where certain companies (C cases only) are required by law to have their accounts approved by the respective authorities. Separate applications for extension of time must be made and each case will be considered on its merits. Discretion lies with Branch Heads who will only consider extension where he is satisfied that because of those requirements returns cannot be submitted within the time specified.
 3. For D (Partnership) cases extension of time after 31.5.1995 will not be allowed.
 4. In the case where the accounting year on or earlier than 30.9.1994 no extension of time beyond 31.5.1995 will be allowed. Where any extension has been inadvertently granted, it shall be deemed as if no extension has been given, if subsequently discovered.
 5. Any Return Forms to be filed within the extended time agreed means a complete Return Form supported by audited/certified accounts, tax computation and

all the required details as stipulated in the Return Forms. Any incomplete returns submitted will be considered as a late lodgement and be thus subject to penalty.

6. A Return Form addressed to a particular taxpayer who is no longer a client should not be used for submission of income of another taxpayer. Instead it should be returned with an appropriate notation.
7. Failure or delay by taxpayer to prepare accounts or supply information to the Accountant or Tax Agent will not be considered as valid ground for extension of time or waiver of penalty unless there are extenuating circumstances.
8. Where the extension of time has been granted upon claims made that a taxpayer is under an instalment scheme and if subsequently this is found to be incorrect, then it will be considered that no extension of time has been given and an appropriate penalty will be imposed on any late submission.
9. Where an assessment is made on the basis of an estimate given in accordance with paragraph 1(c), no formal appeal need to be lodged as the assessment will be revised by the Department on receipt of the complete return within the extended time.

Collection Policy

10. The policy is to collect the tax within the stipulated period and also by means of the instalment scheme under Section 107B Income Tax Act 1967 and monthly deduction from salaries. The

implementation of Section 107B has already been explained in the Explanatory Note issued in 1988.

11. Any credit available to a taxpayer and arising from prior years can also be set off against instalments due but prior arrangements must be made with the Collections Branch.
12. No penalty will be imposed on employees who pay their tax by monthly deductions as required by the Income Tax (Deduction from Remuneration) Rules 1994. There may be cases where the total deduction is insufficient to meet the tax payable based on the notice of assessment. In such cases penalty will be imposed if taxpayer fails to pay the outstanding tax within the time allowed.
13. Accountants and Tax Agents should advise their clients of the necessity to make sufficient provisions for the payment of tax to avoid the late payment penalty. Taxpayers other than SG cases have been made aware that they should commence payment from January or February. A taxpayer who has not been issued with a Notice of Instalment Payment may request to be included in the scheme provided a notice of assessment for the current year has not already been issued to him. However, the instalment payments will not be extended beyond September or October.
14. The Department reserves the right to withdraw or modify any of the concessions agreed upon.

About the MIT Examinations

EXAMINATION SUBJECTS

Level I	Economics, Business Statistics and Computer Knowledge Taxation I Financial Accounting I
Level II	Taxation II Taxation III Company and Business Law
Level III	Taxation IV Taxation V Financial Accounting II Business and Financial Management

WHAT ARE THE ENTRANCE REQUIREMENTS

The Institute admits students with various educational background. The minimum requirements for student registration is that he/she must attain the age of seventeen and has obtained principal passes in at least two subjects (excluding Kertas Am/Pengajian Am) of the HSC/STPM examination or the equivalent. Other qualifications deemed equivalent or to supersede the minimum requirements is listed in the Student's Guide or call the Secretariat for assistance.

WHEN TO REGISTER

You may register as a Student of the Institute at any time. The MIT Examination is held in November/December annually.

The closing date for registration for the 1995 session is 31 March 1995.

APPLYING FOR EXEMPTIONS

Exemptions from specific papers in the MIT Examinations are available to holders of relevant university degrees, diplomas and other professional qualifications. The extent of exemption granted will depend on the level of the qualification attained and the relevance of course content as determined by the Council. All applications for exemption or evaluation of qualification for possible exemption must be made in prescribed forms available in the Student's Guide.

HOW TO REGISTER

Please contact the Institute's secretariat for a copy of the Student's Guide. The Guide contains general information on the Examination and a set of registration form which is to be completed with the necessary documents enclosed and returned to the Secretariat.

The Institute's office is open from 8.30 am to 4.30 pm on Mondays to Fridays and 8.30 am to 12.30 pm on Saturdays.

HOW TO BE AN ASSOCIATE OF THE INSTITUTE

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 5 years practical experience in practice or employment relating to taxation matters approved by the Council would be eligible to be admitted as an Associate of the Institute.

TAXATION AS A CAREER

Tax affects all of us! Every income earner and business - however - small has to think about tax. In this way, there is always a demand for tax consultants. The taxation profession offers a career with a future, with a broad scope of interests and opportunities for advancement. (See Illustration 1 and 2)

Illustration 1

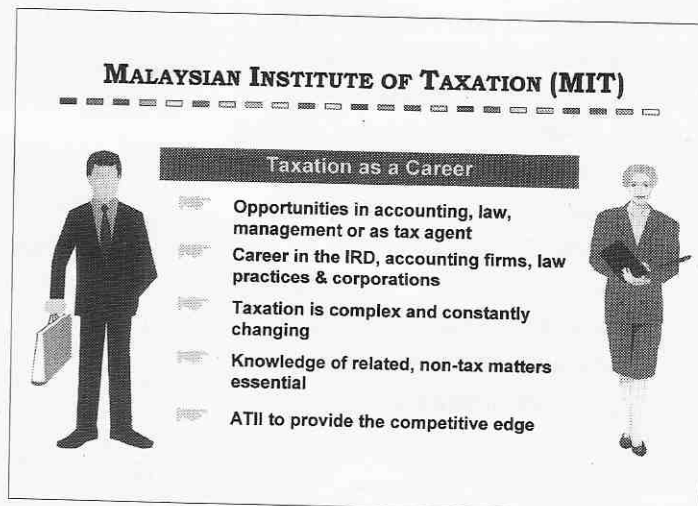
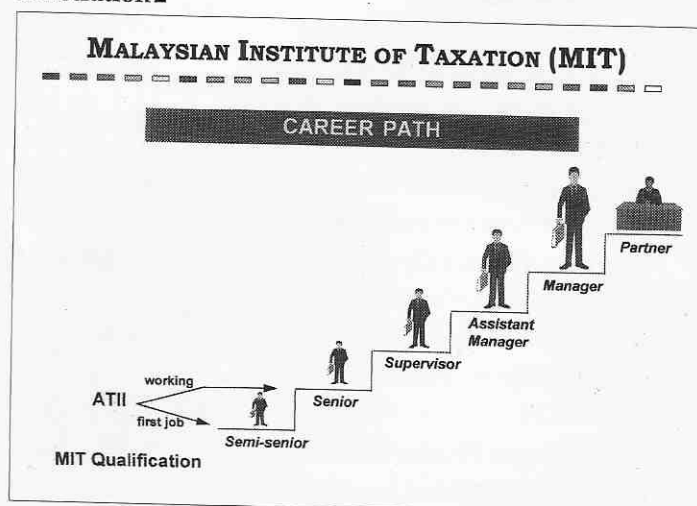


Illustration 2



PROVISIONS OF PRESCRIBED SERVICES TO FREE ZONES - SERVICE TAX -

BY: MR CHUAH SOON GUAN
Council Member

IMPLICATIONS

Whilst the 5% service tax is generally charged and levied inter-alia in respect of any prescribed service provided by or in any prescribed professional establishment or prescribed establishment, it is however not applicable in Langkawi, Labuan and Free Zones. A free zone is defined under the Free Zones Act 1990 to mean any part of Malaysia declared as either a free commercial zone or a free industrial zone. Thus, based on the above provisions in the Service Tax Act, 1975, the scope of the service tax exemption would therefore cover any prescribed services provided to customers in a free zone by either a prescribed professional establishment or a prescribed establishment.

With regards to public accountants who are registered under the Accountants Act, 1967 which therefore constitute a prescribed professional establishment, the prescribed services are the provision of accounting, auditing, book-keeping, consultancy and other professional services normally provided by Public Accountants. Examples of other professional services normally provided by Public Accountants would include for example, taxation and management consultancy services. Examples of the manner in which some of the above prescribed services are usually provided by the public accountants to customers in the free zones are illustrated in the Appendix.

The provision of prescribed services normally culminates in the preparation and submission of a document by the public

accountant to the recipient of services, the customers. For instance, in the case of auditing services, the document provided will be the audited annual accounts which incorporates the auditor's report while in the case of a tax compliance work, tax consultancy assignment or management consultancy assignment, the document provided to the customer would generally be in the form of a report highlighting the findings and recommendations of the subject matter.

In the light of the above, it can be viewed that the prescribed services of the public accountant would be deemed to have been provided to the customer when the document prepared by the public accountant such as the audited annual accounts and reports, for example are received by the customer. Thus, where the customer is in a free zone, the prescribed services of the public accountant would be deemed to have been provided in the free zone when the document, which is the culmination of the provision of prescribed services is provided to the customer.

It should be appreciated that in the course of preparing the document, some of the preparatory services may have been rendered outside the free zone, for instance in the office of the public accountant. As the 5% service tax does not apply to free zones, the consequential effect is that the 5% service tax need not be levied on the fees charged to customers in the free zones for the above prescribed services provided by the public accountants. As all the other prescribed services rendered by public accountants to customers in free zones are

also in the similar manner as discussed above, the 5% service tax would therefore also not apply on the fees charged on these services.

The argument advanced above for non-taxability was based on the 'rendering of services' concept. However at a recent meeting with the head of Service Tax in Customs headquarters Mr. Yeap Hock Sun, we were informed that provision of prescribed services to such areas should be based on where it is performed. In the case of accountants performing auditing, a substantial portion of the work is performed in the office of the auditors whilst for tax compliance, work is wholly in the tax agent's office. Even though proration of the service tax based on proportionate time spent in the office and in the client's premises could be done it was deemed not practical.

MIA/MIT's representatives have appealed that accountants who have not collected the service tax for services provided to clients in free zones be exempted for having to account for the service tax retrospectively. The effective date be based on current date.

MIA/MIT are presently awaiting a written confirmation of the Custom's interpretation. Once received, members will be informed.

APPENDIX

Continuation from page 29

PREScribed SERVICES

TYPICAL MANNER IN WHICH THE PREScribed SERVICES ARE CARRIED OUT

A) Auditing

- 1) Pre-audit discussion with customer for the following purposes:-
 - a) agreeing on the time table for audit
 - b) understanding customer's business and operations
- 2) Audit field work carried out at customer's premises
- 3) Audit Partner/Manager's review of audit workpapers at auditor's office or at customer's office
- 4) Discussions with customer on post-audit issues at customer's office or auditor's office
- 5) Issuance of auditor's report and submission of audited annual accounts to customer in a free zone

B) Taxation

a) Compliance

- 1) Preparation of tax return and computation based on customer's audited accounts
- 2) Discussion with client either at accountant's office or customer's premises to obtain further information or clarification.
- 3) Finalisation and submission of tax computations for customer's approval before submission to Inland Revenue Department
- 4) Once customer has approved the tax computation and return, they will be submitted to the IRD

b) Consultancy

- 1) Meeting with customer either at accountant or customer's office to discuss subject matter.
- 2) Preparation of consultancy report at accountant's office or sometimes, at customer's premises
- 3) Submission of report to customer
- 4) Further discussion at customer's office to discuss findings and recommendations

C) Management Consultancy

- 1) Meeting with customer either at accountant or customer's office to discuss subject matter
- 2) Preparation of consultancy report at accountant's office or sometimes, at customer's premises
- 3) Submission of report to customer
- 4) Further discussion at customer's office to discuss findings and recommendations

employees have been subject to the STD. Please confirm that this will be case.

- j) The IRD should consider waiving penalties for non-compliance for the first few months, especially for newly incorporated companies which have not been registered with E reference numbers and for expatriates who are awaiting their work permit approval and have yet to be registered with a tax file. Do companies have to apply on an individual basis for an extension of time to comply?

- k) Please confirm that STD can be paid for expatriates who have started work in Malaysia but have not been registered with a tax file, so long as the E file number is available for the employer is available.

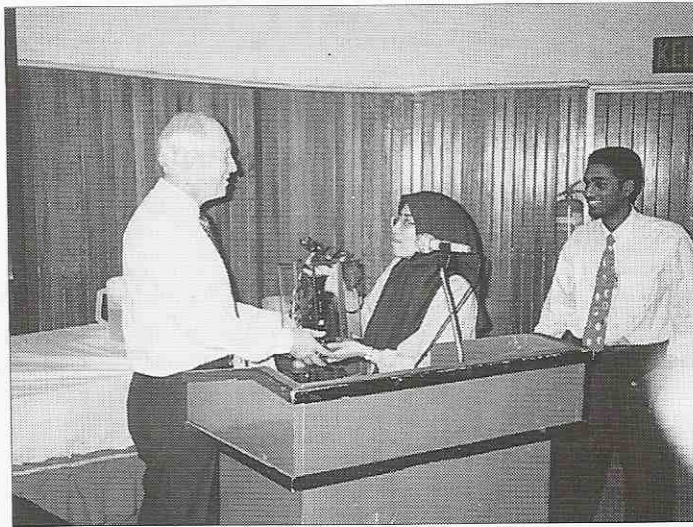
In the situation where the E file number and the expatriate's tax reference number are both not available, is there any way his tax can be paid? If tax is not paid due to the said reason, can the amount be paid in the subsequent month when the number is available? Under this circumstance, will there be a penalty imposed?

- l) Please confirm that the STD needs to be complied for non-resident employees although the STD table is based on resident tax rates.
- m) In certain industries, it is unclear whether the persons engaged is actually an employee under a contract of service or an independent contractor under a contract for service. e.g. In stockbroking firms, a corporate dealer earns a fixed salary and a commission based on performance. Likewise for a branch manager of car dealing company. Please confirm that the STD is applicable only to the fixed salary while the STD is not applicable to commission as it would be treated as business income of the employee for tax purposes.

Around the Campus ...

In the month of January this year, the Institute was invited to deliver career talks at two campuses, one being at Universiti Utara Malaysia (UUM), Kedah and the other at Politeknik Ungku Omar, Perak. The talks were organised by the campuses' respective Accountancy Clubs.

The earlier Career Talk at UUM was held on 9 January 1995. A tax practitioner in Alor Setar, Mr Chang



Mr. Richard Thornton (left) being presented a souvenir by Cik Aziza of Politeknik Ungku Omar. Chairman of the talk, Mr Easwaran Kandasamy (right) looks on

Kok Foo represented the Institute to give an inspiring talk entitled "Prospects and Challenges in Taxation" to students of UUM.

Meanwhile at Politeknik Ungku Omar, Mr Richard Thornton spoke on the role of the Institute and "Making a Career in Tax". Mr Thornton also took this opportunity to inform students of the Politeknik on the forthcoming MIT Examinations.

MIT/MIA Forms Working Committee with IRD

IRD invited the Institute and Malaysian Institute of Accountants (MIA) to assist in formulating guidelines to determine whether rental income received is Section 4(a) or Section 4(d) income.

The Institute nominated representatives to the above Working Committee. The Institute is of the view that the Working Group could be used as a vehicle to raise other contentious issues where formulation of guidelines is required.

The first meeting was held on 25 January 1995. Mr Quah Poh Keat, Mr Arjunan Subramaniam and Ms Nancy Yeoh represented both Institutes.

Richard Thornton appointed ACCA Examiner

Richard Thornton, our regular columnist for the journal's Students Section was recently appointed as Examiner for Paper 11 (M) Tax Planning by Chartered Association of Certified Accountants (ACCA). His first assignment will be the setting of the June 1995 paper. Richard is also a member of the Institute's Examinations Committee and Editorial Board Committee.

Professionally, Richard is a Visiting Associate Professor in Universiti Kebangsaan Malaysia and he is attached to the Faculty of Business Management in the Department of Accounting.

C O N T R I B U T I O N

Tax Nasional invites readers to contribute articles for publication. By contributing to the Tax Nasional, you will gain valuable recognition and our readers will benefit from sharing your experience. An honorarium will be paid for articles which are published.

The Royal Customs and Excise Malaysia has informed the Institute of the new placement of the following senior officers effective January 1995:

Bani b. Roslan

Timbalan Pengarah
Cawangan Import/Eksport
Ibu Pejabat

Saadon b. Hj. Mohd. Dros

Penolong Pengarah
Cawangan Cukai Jualan
Ibu Pejabat

Abdullah b. Hj. Abd. Rahim

Penolong Pengarah
Cawangan Industri
Ibu Pejabat

Shaharuddin b. Ibrahim

Penolong Pengarah
Cawangan Cukai Jualan
Wilayah Persekutuan

Zaharah bt. Ahmad

Penolong Pengarah
Cawangan Cukai Jualan
Wilayah Persekutuan

Mohd. Sopian b. Mohd. Rashid

Penolong Pengarah
Unit Kontena (Eksport)
Pelabuhan Kelang

Che Mas bt. Hashim

Penolong Pengarah
Cawangan Kargo
LTA, Subang

Mat Yusof b. Abdullah

Pengarah Kastam
Negeri Pahang

Subbiah @ Raman a/l Karuppiah

Penolong Pengarah
Cawangan Pencegah
Pulau Pinang

Mohamad b. Jaafar

Penolong Pengarah
Cawangan Eksais
Pulau Pinang/Seberang Perai

Seetalata a/p Adris

Penolong Pengarah
Cawangan Industri
Ipoh

Rokiah bt. Abdullah

Penolong Pengarah
Cawangan Cukai Perkhidmatan
Johor

Nadzrah bt. Abdullah

Penolong Pengarah
Cawangan Industri
Johor Bahru

Roslan b. Md. Noor

Penolong Pengarah
Pasir Gudang
Johor

Chung Tsu Hsien

Penolong Pengarah
Cawangan Import/Eksport
Ibu Pejabat

Othman b. Ibrahim

Penolong Pengarah
Cawangan Industri
Ibu Pejabat

Lam Ahmad b. Hassan

Penolong Pengarah
Cawangan Pencegah
Wilayah Persekutuan

Omi Marsom bt. Mohd. Tahir

Penolong Pengarah
Cawangan Eksais
Wilayah Persekutuan

Mohd. Zan b. Ali

Penolong Pengarah
Cawangan Pencegah
Selangor

Ibrahim b. Hamid

Penolong Pengarah
Cawangan Import
Pelabuhan Kelang

Zainal b. Mustaffa

Pengarah Kastam
Negeri Kedah

Mohamad b. Md. Zain

Penolong Pengarah
Cawangan Pencegah
Butterworth

Low Tak Fun

Penolong Pengarah
Cawangan Import/Eksport
Pulau Pinang

Shuib b. Haji Salleh

Penolong Pengarah
Cawangan Industri
Seberang Perai

Nurlis b. Haji Mohd. Nor

Penolong Pengarah
Cawangan Pencegah
Terengganu

Faridah bt. Che Lah

Ketua Bahagian Cukai Dalam
Johor

Lim Poh Huat

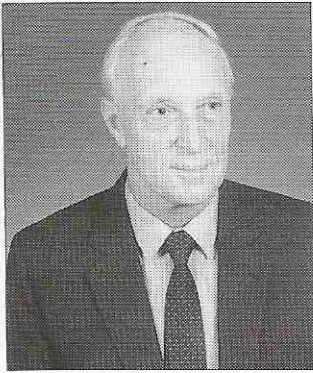
Penolong Pengarah
Cawangan Pencegah
Johor Bahru

MEMBERSHIP STATUS OF MIT AS AT 3 NOVEMBER 1994

Honorary Fellows	4
Fellows (Founder Council Members)	15
Associate Members*	888
Deceased	(1)
	<hr/> 906

* Associate Members

Public Accountants of MIA	607
Registered Accountants of MIA	74
Licensed Accountants of MIA	16
Advanced Course Exam of IRD	82
Advocates & Solicitors	5
Approved Tax Agents	99
Others	5
Deceased	(1)
	<hr/> 887



The Taxation Of Partnership Income

Prepared by:

RICHARD THORNTON

Visiting Associate Professor, Universiti Kebangsaan Malaysia

WHAT IS A PARTNERSHIP

In five different sections, the Income Tax Act 1967 lays out the main rules for taxing partners in a partnership.

Before applying those rules we have to be quite sure what we mean by partnership. The words "partner" and "partnership" are much used in ordinary language. For example, a person will often refer to his wife as his partner. When we talk about partnership in a legal sense, we need to look at the Partnership Act 1961. Besides defining the meaning of partnership, it deals with matters such as the relations of partners to persons dealing with them and the relations of partners one to another.

According to the Act, partnership is the relation which subsists between persons carrying on business in common with a view of profit. There are three elements to the definition. "Carrying on business" means that there must be an activity falling within the definition of "business" which is stated to include "every trade, occupation or profession". This is similar to the definition of business for income tax purposes so we can assume that an activity the income of which is charged to tax under Section 4(a) of the Income Tax Act 1967 will also be an appropriate partnership activity. The notable exception is that the Partnership Act 1961 does not include "every manufacture or concern in the nature of trade" as does the Income Tax Act 1967. A trade must be a real trade. The persons must carry on the business "in common" which implies the sharing of all rights and responsibilities. Finally, there must be "a view of profit". An activity intended to be non profit making cannot be a partnership.

In many cases it will be easy to see whether an activity constitutes a partnership. The Partnership Act 1961 refers to certain

activities which are not to be taken to be partnership unless there is other evidence of intention to carry them on in partnership. For example:-

- (i) joint tenancy, tenancy in common, joint property, common property or part ownership
- (ii) the sharing of gross returns
- (iii) the receipt of a share of profits by way of annuity in consideration for the sale of business goodwill

On the other hand, the receipt by a person of a share of profits of a business is *prima facie* evidence that he is a partner in the business. Where this applies it is necessary to look at all of the circumstances to decide whether there is a partnership. This can be particularly relevant when a person working in the business receives a share of profits. If all of the other evidence points to a master/servant relationship he will not be a partner. It is not uncommon for a person to be called a "salaried partner". If he is held out to be a partner, third parties will be entitled to treat him as such but whether he is a partner in relation to the other partners, and for tax purposes, is again to be decided on the evidence. If the evidence points to the intention to create a partnership situation, then he will be a partner but if it points to a master/servant relationship then he will be an employee and not a partner.

COMPUTATION OF ADJUSTED INCOME

A partnership is not a separate legal entity so each partner is charged to tax individually on his share of partnership income. However, in order to determine any particular partner's share of income, a little pretence is required. The partnership is first treated as a single business, referred to in the Income Tax Act 1967 as the proprietorship business. This is achieved by assuming that the whole of the business

and assets together with all rights and liabilities of the partnership have been transferred to the individual partner, that the business is carried on by him in the same way as it is carried on by the partners and that the accounts of the partnership are the accounts of his own business. The pretence continues throughout the whole of the period for which he is a partner.

To calculate the adjusted income of the partnership, the normal principles of income tax are used, such as the rules relating to the determination of basis periods and the ascertainment of gross income and deductions. The amount of adjusted income found in this way for a basis period for a year of assessment is referred to as the individual partner's provisional adjusted income.

Every partnership will have its own particular rules as to how profits or losses are to be shared between partners. This may be set out clearly in a partnership agreement or it may be an informal understanding between the partners. Often, partners are entitled to a fixed sum (sometimes referred to as partners' salaries) and the balance after such entitlements is divided in fractional shares. Partners may also be entitled to receive interest on capital provided to the partnership. Neither salaries nor interest paid to partners may be deducted in arriving at the provisional adjusted income of the partnership business.

In the next stage, the divisible income of the partnership business for the basis period is determined. This is done by starting with the provisional adjusted income and making a series of deductions for the following amounts payable for the basis period:-

- (i) remuneration to partners (i.e. partners' salaries)

- (ii) interest payable to partners (other than in a fiduciary capacity)
- (iii) any expense charged in the partnership accounts which represents private or domestic expenses of a partner

See Example 1

At the final stage, the partner's share of adjusted income is found by taking the partner's fractional share of the divisible income and adding back the amount attributable to him out of the amounts deducted in arriving at the divisible income.

Where profit sharing arrangements change during a basis period, the divisible income is treated as accruing evenly over the basis period and then apportioned between the partners according to their entitlements from time to time.

See Example 2

CAPITAL ALLOWANCES

Usually, a partnership will have some assets which qualify for capital allowances. These are treated as being owned jointly by the partners and each partner will be entitled to a share of the capital allowances calculated for a year of assessment. The calculations are made in the normal way based on the qualifying expenditure incurred during the basis period for the year of assessment and assets in use at the end of that period. A partner's share is calculated based on his entitlement (if any) to share profits at the end of the basis period. So long as the partnership business remains substantially the same and there is at least one continuing partner, changes in the partnership such as retirements or the admission of new partners are ignored. Capital allowances will continue to be calculated as for a continuing business.

Sometimes an asset which is used in the partnership business is owned by a partner individually. In that case the partner concerned will be entitled to the whole of the capital allowances for that asset.

The statutory income of a partner from the partnership business is calculated in the normal way as laid down in the Income Tax Act 1967. His share of capital allowances will reduce his share of the adjusted income (and his share of a balancing charge will increase it). Any allowance that can-

EXAMPLE 1

X, Y and Z carried on business in partnership. The partnership profit and loss account for the year to 31st March 1994 was as follows:-

	RM	RM
Gross income from sales		500,000
Less: Consumed of Raw materials	144,000	
Overheads (including disallowable subscriptions RM4,000 and private expenses of partner X, RM6,000)	100,000	
Depreciation	30,000	
Interest on capital (X, RM12,000 and Y, RM8,000)	20,000	
Partners' salaries (X, RM35,000, Y, RM45,000 and Z, RM20,000)	100,000	394,000
Partnership profit (shared 50:30:20 up to 31-12-93 and then 40:35:25)		106,000

Provisional adjusted income and divisible income in relation to each partner is calculated as follows:

Partnership profit		106,000
Add: Disallowable subscriptions	4,000	
Private expenses of X	6,000	
Depreciation	30,000	
Interest on partners' capital	20,000	
Partners' salaries	100,000	160,000
Provisional adjusted income		266,000
Less: Partners' salaries	100,000	
Interest on partners' capital	20,000	
Private expenses of X	6,000	126,000
Divisible income		140,000

EXAMPLE 2

Facts as in EXAMPLE 1. The adjusted income of each partner for the year of assessment 1995 can be ascertained as follows:-

	X	Y	Z	Total
Shares of divisible income (RM140,000)				
to 31/12/93, 9/12ths shared 50:30:20	52,500	31,500	21,000	105,000
from 1/1/94, 3/12ths shared 40:35:25	14,000	12,250	8,750	35,000
Partners' salaries	35,000	45,000	20,000	100,000
Interest on partners' capital	12,000	8,000	-	20,000
Private expenses of X	6,000	-	-	6,000
	119,500	96,750	49,750	266,000

not be used due to an insufficiency of income is carried forward by him and included with the allowances for the following year.

See Example 3

NON BUSINESS INCOME

Income of the partnership which is not business income, such as rent, is computed for tax purposes according to the rules applicable to the particular source of income (including the rules applicable to basis periods) and then apportioned between the partners in their profit sharing ratios. The amounts so computed will be charged to tax separately from the business income of the partner.

PARTNERSHIP CHANGES

When a person ceases to be a partner or a new partner is admitted, there is in fact a cessation of the old partnership and the commencement of a new one. Where accounts continue to be made up for successive periods of twelve months and the partnership change takes place at an accounting year end, basis periods for years of assessment will normally be unaffected by the change. Each partner's share of adjusted income will be calculated according to his entitlement to share profits from time to time. In relation to any person who was a partner in the old partnership and continues to be a partner after the change, the partnership business is treated as continuing unbroken even if the change takes place part way through the accounting year so that there is no revision of basis periods and that partner's share of adjusted income is calculated in the normal way.

However, a change of accounting date may necessitate a revision of basis periods.

See Example 4

PARTNERSHIP LOSSES

In a loss situation the calculations proceed in much the same way as outlined above. An adjusted loss will arise instead of provisional adjusted income where the initial computation produces a negative result. To this is added the sum of the 3 categories of adjustment referred to under COMPUTATION OF ADJUSTED INCOME to give the divisible loss. An initial amount of provisional adjusted income may also become a divisible loss if it is less than the

EXAMPLE 3

The fixed assets of the partnership in EXAMPLE 1 consisted of new items of office equipment acquired in the year to 31st March 1994 at a cost of RM30,000 which were in use at the end of the basis period along with office equipment acquired in the previous two years at a cost of RM150,000. In addition, partner Y claimed capital allowances for business use - estimated at 25% - of his car which had cost him RM60,000 2 years before. Capital allowances are calculated as follows:-

	Office Equipment	Motor Car
Rate of annual allowance	12%	16%
	RM	RM
Cost/available limit	180,000	50,000
Initial allowance - 20%	6,000	
Annual allowance	21,600	2,000
	27,600	2,000

Statutory incomes of the partners for year of assessment 1995 are:-

	X	Y	Z
Share of adjusted income	119,500	96,750	49,750
Capital allowances on			
office equipment - shared 40:35:25	(11,040)	(9,660)	(6,900)
Capital allowances on motor car		(2,000)	
	108,460	85,090	42,850

EXAMPLE 4

A and B were in partnership sharing profits equally until 1st April 1993 when A retired. A new partner, C, was admitted sharing profits with B in the proportions 60:40. Accounts were made up for the year to 30th September 1992, the 6 months to 31st March 1993 and the year to 31st March 1994 with divisible income of RM120,000, RM64,000 and RM140,000 respectively.

	A RM	B RM	C RM	Total RM
Divisible income is shared as follows:-				
Year to 30th September 1992	60,000	60,000		120,000
6 months to 31st March 1993	32,000	32,000		64,000
Year to 31st March 1994		84,000	56,000	140,000

Shares of adjusted income will be:-

Year of assessment 1993	60,000	60,000	
Year of assessment 1994	32,000	see note	
Year of assessment 1995		84,000	56,000

The change of accounting date affects B as the continuing partner. The Director General of Inland Revenue will make a direction as to basis period for year of assessment 1994.

sum of the 3 categories of adjustment referred to.

The divisible loss is then divided between the partners in the same way as an amount of divisible income would have been divided. An individual partner's adjusted loss is found by deducting the amount attributable to him out of the amounts added in arriving at the divisible loss.

Where the additions made for a particular partner at that last stage result in a positive figure, he will have adjusted income and not an adjusted loss for the basis period for a year of assessment.

Relief to a partner for an adjusted loss is given according to the rules set out in section 44 of the Income Tax Act 1967. Relief is given primarily against his aggregate income for the same year of assessment, which will include income from all other sources whether business or non-business. To the extent that his aggregate income is insufficient to cover it, the adjusted loss is carried forward (and added to any previous loss unrelieved) for relief against his statutory income from any business source for future years of assessment.

See Example 5

NON INDIVIDUAL PARTNERS

A partner in a partnership may be a company or another partnership (referred to as a sub partnership). In such a case, the share of adjusted income of that particular partner will be ascertained in the same way as for an individual partner. That share, in the case of a company, will form a separate source of business income of the company. For a sub partnership, the share of adjusted income from the main partnership will be allocated to its partners in the manner described above and they will then be charged to tax individually.

OTHER ASPECTS

The taxation of partners may be affected by other circumstances such as the payment of annuities to retired partners or their families, partnership changes which trigger cessation or deemed disposal provisions in relation to valuation of assets or dealing in assets between partners. This article has covered only the general aspects of partnership taxation.

EXAMPLE 5

D and E were in partnership sharing profits equally after charging partners' salaries of RM21,000 and RM15,000 respectively. Accounts were made up to 31st December in each and the results for 1993 produced an adjusted loss of RM50,000 whilst those for 1994 produced provisional adjusted income of RM90,000. Net rental income from partnership property amounted to RM20,000 in each year. The partners had no other sources of income and the position is as follows:-

	D RM	E RM	Total RM
Year of assessment 1994			
Adjusted loss			50,000
Add partners' salaries			36,000
Divisible loss	43,000	43,000	86,000
Deduct partners' salaries	21,000	15,000	
Adjusted losses	22,000	28,000	
Less net rental income	10,000	10,000	
Adjusted loss carried forward	12,000	18,000	
Year of assessment 1995			
Provisional adjusted income			90,000
Deduct partners' salaries			36,000
Divisible income	27,000	27,000	54,000
Add partners' salaries	21,000	15,000	
Adjusted business income	48,000	42,000	
Less adjusted loss b/f	12,000	18,000	
Statutory income	36,000	24,000	
Net rental income	10,000	10,000	
Aggregate income	46,000	34,000	

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