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MEMORANDUM TO THE HONOURABLE Minister of Finance

● MEMORANDUM TO MINISTER OF FINANCE ● YAB DATO' SERI ANWAR IBRAHIM ●
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Malaysian Institute Of Taxation

C O N T E N T S

TAX NASIONAL

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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:

1. To provide an organisation for persons interested in or concerned with taxation matters in Malaysia.
2. To advance the status and interest of the taxation profession and to work in close co-operation with the Malaysian Institute of Accountants (MIA).
3. 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.
4. To provide examination for persons interested in or concerned with the taxation profession.

Malaysian Institute Of Taxation

MALAYSIAN INSTITUTE OF ACCOUNTANTS
MALAYSIAN INSTITUTE OF TAXATION

MEMORANDUM

TO THE
HONOURABLE MINISTER OF FINANCE

The Malaysian Institute of Accountants (MIA) and the Malaysian Institute of Taxation (MIT) congratulates the Minister for continuing to guide the country to growth in excess of 8% again in 1994 and in maintaining a balanced budget in spite of the reductions of personal income tax and corporate tax over the past years.

In spite of the reduction in tax rates, tax collection has grown further due to an expanded economy, more efficient collection and administration of tax and redefining the investment incentives under the Promotion of Investments Act, 1986.

MIA/MIT would suggest that the Minister continues the good work in reducing both the personal tax rate and the corporate tax rate. As for the personal tax rate, a first step towards reduction of the top tax rate to 30% to peg it to current corporate tax rate should be considered (Appendix I). There should also be a programme to reduce the corporate tax and top personal tax rates to 25%. These reductions are necessary, particularly to compensate for the burden of Sales and Service Tax (SST) when introduced. SST when introduced should also be not more than 3% (Appendix II).

Other suggestions of MIA/MIT are as follows :-

1. **Promotional education in order to encourage and promote education in Malaysia with significant spin-offs resulting in growth of the service sector as well as benefit to the construction industry (Appendix III)**
   We would suggest that consideration be made to grant industrial building allowance to private school buildings.

2. **Promotion of Training - Double Deductions (Appendix IV)**
   Inclusion of MIA and MIT in the list of approved training institutions so that employers can claim double deduction for training expenses. This will inculcate a training culture among our corporate citizens and smoothen the path to realising the goals of Vision 2020.

3. **Operational Headquarters (OHQ) (Appendix V)**
   Further liberalisation of OHQ should be considered in order to make Malaysia attractive. Companies from Hong Kong particularly would have to consider relocating their OHQ in the next 2 years. Singapore and Australia are major players in this area.

4. **Unit Trust Exemptions (Appendix VI)**
   Unit trust exemptions to unit holders should be considered to encourage Malaysians to save instead of spending.

5. **Reforms for Women (Appendix VII)**
   Women have contributed equally to our economic sectors and we would suggest that the tax system cater for them in their own right as femme sole.

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MIT/MIA Attend Pre-Budget Dialogue

The Malaysian Institute of Taxation/Malaysian Institute of Accountants (MIT/MIA) were invited to attend a pre-Budget Dialogue with the Minister of Finance at Labuan on 5 August 1995. MIT Council members, Mr Chow Kee Kan and Mr Ranjit Singh represented both Institutes.

The theme of the dialogue was "Promoting a Modern, Competitive and Dynamic Services Sector". In accordance with the theme, the dialogue was attended by representatives of organisations from the Financial and Insurance sector, the Transport and Communications sector and the Business and Professional Services sector. Invitations were also extended to various individuals of repute to present their views.

Common issues raised by representatives from various sectors were concerned with human resource development and the impact of information technology. Much of the discussion revolved around the country's services account deficit in the balance of payments and possible measures to contain or reduce it.

The Minister of Finance assured the participants that all memoranda submitted would be studied carefully and taken into consideration in drawing up the 1996 Budget.

6. **Full Deductibility For Professional Expenses `(Appendix VIII)**
Professional expenses such as accounting, secretarial and audit fees for investment companies should be allowed a full deduction as these expenses are necessary operational expenses incurred in order to carry on the business in compliance with the law.

7. **Service Tax of Professional Services in Free Zones (Appendix IX)**
Services rendered to companies located in the Free Zones should not be subject to service tax based on the concept of "rendering of services" as in exports which are zero rated as the intention of the statutes is the enjoyment of tax exemption.

8. **Improvement of Environment (Appendix X)**
Tax incentive be liberalised for capital expenditure on plant and machinery incurred for waste disposal.

9. We would also suggest the following measures to keep up with the times and to improve administration of tax.

(a) Capital Allowances

i) Rate of Capital Allowances (Appendix XI)
Rates of capital allowances should be simplified.

ii) Assets Costing RM1,000 and Below (Appendix XI)
Assets costing RM1,000 and below should be allowed to be written off as a revenue expenditure instead of having capital allowances calculated on item by item.

iii) Qualifying Expenditure for Motor Vehicles (Appendix XI)
Qualifying expenditure for motor vehicles not licensed for commercial transportation of passengers and goods should be increased from RM50,000 to RM80,000.

(b) Back Years Assessment (Appendix XII)
Back years assessment should be limited to 6 years instead of 12 years currently.

(c) Interest for Taxes Overpaid by Taxpayers (Appendix XIII)
Interest should be paid to taxpayers for taxes overpaid.

10. **Changes in Petroleum Income Tax (Appendix XIV)**
We also list down suggested changes that should be considered for Petroleum Income Tax.

11. **Inclusion of accountants as "investment advisers" (Appendix XV)**
We propose for the inclusion of accountants as "investment advisers" as defined in the Securities Industry Act, 1983.

Appendix I

A CASE FOR REDUCTION OF INDIVIDUAL TAX RATES

In view of the continued growth of the Malaysian economy which is expected to expand at 8+% in 1995, we propose a reduction of individual tax rates to a maximum of 30 per cent and fewer bands for progressive taxation. The proposed changes are illustrated in Appendix Ia.

The proposed changes will :

i) compensate individuals for the higher cost of their "shopping baskets" owing to inflation and the proposed introduction of a sales and service tax;

ii) reduce "brain drain" especially to Singapore if the gap in tax rates is at least narrowed;

iii) encourage expatriates to relocate in Malaysia in view of the more competitive individual tax rates.

With the reduction in tax rates, consumers will be compensated for the increased tax burden due to SST and general price increase over the years.

We have also proposed fewer bands for progressive rates, although the chargeable income or income group for each band remains comparable to the existing income bands. This should spread the benefit of the lowering of the top rates to those income group below RM150,000 to ensure a more equitable distribution of lowered tax rates.

The proposed top rate at 30% though is equal to that of our neighbouring country Singapore, Singapore's top rate applies to chargeable income in excess of S$400,000 while Malaysia is on chargeable income in excess of RM150,000. Overall, even with the reduction in tax rate, Malaysia's tax is still higher than that of Singapore. Tax reduction is needed more so as to increase the quality of life of Malaysians and to reduce "brain drain" especially to Singapore.

Further, with revenue growth keeping pace with the growth in the national economy, the loss in revenue, if any, will be insignificant. A reduction of individual tax rate should be taken as compensation for the burden of consumption tax (i.e. the SST) on the consumer if introduced.

Q U O T E

Never cease to be convinved that life might be better - your own and others

- Andre Gide -

Malaysian Institute Of Taxation

Appendix Ia

MALAYSIAN TAX TABLE FOR INDIVIDUAL PROPOSED FOR YEAR OF ASSESSMENT 1996

	Chargeable Income RM	Current Rate %	Current Income Tax Payable RM	Proposed Rate %	Proposed Income Tax Payable RM
On the first	2,500		0	0	0
On the next	2,500	3	75	0	0
On the first	5,000		75		0
On the next	5,000	6	300	0	0
On the first	10,000		375		0
On the next	10,000	7	700	5	500
On the first	20,000		1,075		500
On the next	15,000	12	1,800	5	750
On the first	35,000		2,875		1,250
On the next	15,000	18	2,700	15	2,250
On the first	50,000		5,575		3,500
On the next	20,000	23	4,600	15	3,000
On the first	70,000		10,175		6,500
On the next	30,000	28	8,400	25	7,500
On the first	100,000		18,575		14,000
On the next	50,000	31	15,500	25	12,500
			34,075		26,500
On all income exceeding	RM150,000	32		30	

Appendix II

A MAXIMUM RATE OF 3% FOR SALES AND SERVICE TAX (SST)

Introduction

It has been proposed that Sales and Service Tax (SST) which is to be introduced will combine Sales Tax and Service Tax into a single consumption tax. SST being a consumption tax is levied or based on goods and services consumed. Since SST can be imposed on multi-stage basis, it would also improve efficiency in indirect tax collection. In addition, as SST is a tax on consumption, it will encourage savings and may, at the same time, check unnecessary or compulsive consumption.

It is proposed that the rate of SST should not be more than 3 per cent. A 3 per cent SST will be more acceptable to the public and not over-burden consumers whilst at the same time maintaining the required level of indirect tax revenue. Currently sales tax and service tax which are not multi-stage are levied at 5, 10 and 15%.

In deciding on an appropriate rate for SST, it would be necessary to compare the current rate of Goods and Service Tax in Singapore which is only 3%.

Goods and services exported should be zero rated to promote Malaysia as a trading nation.

On a similar basis, if SST is not introduced, export services rendered by both companies and individuals should be exempted from service tax including sales of services to companies located in Free Zones. A closer examination of the meaning of export services in the case of professional services, consultancy, advertising, forwarding services and telecommunication services should be made. A clearer definition is required to avoid confusion under, and abuse to, the Service Tax system.

Appendix III

PROMOTION OF EDUCATION

Industrial Building Allowance

Tertiary education as an industry contributing to foreign exchange earnings is growing in Malaysia. Malaysia has, over the years, built up a comprehensive educational system and this should be fully exploited by both the Government and the private sectors. The availability of a core of academicians and professionals fluent in both the national language and the English language has placed Malaysia in a unique position to tap the education market. This will be an invisible export of services and not only will it bring in foreign exchange, it may even save Malaysia the foreign exchange spent on educating its students abroad.

It also follows that if foreign students are attracted to attend secondary and tertiary education in Malaysia, parents and relatives will very likely visit their children in Malaysia. Even assuming that parents will only visit Malaysia once to attend their children's graduation, this works out to be a visit of two persons for every child receiving education in Malaysia. The "spin off" of promoting education is that tourist arrivals in Malaysia will increase, resulting in growth in the tourist industry and the construction industry as well.

MIA/MIT envisage that if education as an export service is encouraged, there will be an increase in the construction of new buildings to house educational establishments as well as hotels and tourism projects. The multiplier effect has not been quantified but is expected to be substantial.

In the last Budget (1995), the Government has extended the definition of industrial buildings to include buildings used for training by companies providing industrial, technical or vocational training. It has also granted technical or vocational training institutions exemption from import duties, sales tax and excise duties on materials, machinery and equipment used for training. For the employees who further their education in an institution in Malaysia in technology, vocational and industrial fields, they are given tax deduction on their education fees of up to a maximum of RM2,000.

As an initial step, MIA/MIT would propose that the Government extends its incentives by treating all private educational buildings as industrial buildings whereby an industrial building allowance equivalent to 10 per cent initial allowance and 6 per cent annual allowance is given. In addition, import duty

and sales tax exemption should be given on all equipment (e.g. laboratory equipment) used in an educational establishment.

Appendix IV

PROMOTION OF TRAINING - DOUBLE DEDUCTIONS

Improvements to the double deduction incentive for training was made with effect from the year of assessment 1992. The criteria for the granting of double deduction to a non-manufacturing company are that the company must be incorporated or registered in Malaysia, its trainees of Malaysian citizenry and in full-time employment. In addition, the training should be conducted by an approved training institution. The approved training institutions currently comprise :-

(i) National Productivity Centre

(ii) Standards and Industrial Research Institute of Malaysia

(iii) MARA Institute of Technology

(iv) Malaysian Agricultural Research & Development Institute

(v) Forest Research Institute of Malaysia

(vi) Centre for Instructor and Advanced Skill Training

(vii) Penang Skills Development Centre

(viii) Institut Kemahiran MARA

The Malaysian Institute of Accountants and its sponsored organisation, the Malaysian Institute of Taxation desire to be included in the above list. The following are some grounds on which the bodies should be considered for inclusion in the list:-

Statutory Body

The MIA was formed by an Act of Parliament, the Accountants Act 1967 with the objective of regulating the accountancy profession. Its role is equivalent with those of the Bar Council for the lawyers and the Institution of Engineers for the engineers. The Accountants Act 1967 also covers the practice of taxation which the MIA has accommodated the activity in a sponsored body, the Malaysian Institute of Taxation, whose Council includes nominated members from the MIA.

Proven Capabilities in Training

Since 1987, the MIA has organised a big number of training courses and major international conferences. In fact this ability has been recognised to the extent that the Confederation of Asian and Pacific Accountants (CAPA) has awarded the MIA the privilege to host the 1996 CAPA Conference where some 2,500 participants are expected.

Importance of MIA/MIT Type Courses

The courses organised by the MIA/MIT are wide ranging in topics covering management subject matters, accounting, auditing, taxation and commercial laws. This is due to the fact that an accountant has to be familiar with a wide variety of subject matters. Whilst courses are organised primarily for members who are qualified, frequently, such courses are also meant for semi-qualified accountants and other support staff like accounting technicians.

MIA/MIT courses therefore, not only benefit its some 9,000 members, they are useful to support staff such as clerks, assistant accountants and accounting technicians.

Financial Support to Training Capability

The MIA, even though is a statutory body, does not have financial support from the government. It is dependent on members' subscriptions to operate. Unlike medicine where the government has the Health Ministry to regulate it, engineering having the Ministry of Works, and law, the Ministry of Justice, the regulation of accountancy profession rests solely with the MIA. Regulation will entail education and training both pre-and post-graduates. With increasing inflation, the pressure to maintain its services is great especially if members' subscription are to be kept low.

The option available here is to have some contribution from selling courses to cover deficit from the operation based on members' subscriptions. Allowing employers sending participants attending MIA/MIT courses to claim double deduction is an incentive for more companies to send their accounting and management personnel for training. When this happens the real impact of education and training and the resultant long-term growth could then be felt.

More participation especially from outside the Klang Valley locations could be encouraged. Presently courses other than in the Klang Valley are not well patronised and the MIA subsidises such locations.

CONCLUSION

Just as manufacturing concerns are important to boost exports earnings, the support to manufacturing activities in financial management, audit and other accounting based functions are equally important if growth is to be orderly and sustained. Some assistance to the MIA and MIT in the form of the respective bodies' inclusion in the list of approved training institutions for companies to claim double deduction for training will go a long way to expand training, inculcate a training culture among our corporate citizens and smoothen the path to realising the goals of Vision 2020.

Appendix V

OPERATIONAL HEADQUARTERS (OHQ)

It is commendable that the scope of the OHQ incentive has been extended over the years. When it was first introduced in the 1988 Budget, it was confined to the manufacturing sector. Since then, the scope of the incentive has been reviewed on a number of occasions, with significant changes being made in 1993 and 1994 to further promote Malaysia as an international centre for providing research, management and financial services. In the 1995 Budget, the OHQ incentive, which was previously confined to companies which are wholly owned by foreign companies or individuals. was extended to locally owned companies.

Along with Section 3C of the Income Tax Act, 1967 (effective from the year of assessment 1995) which exempts resident companies from income tax on income derived from sources outside Malaysia, Section 60E of the Act was amended with the deletion of subsection (5) which allows tax exempt dividends to be franked out of dividends received from overseas (which are exempt from Malaysian income tax for a period of 10 years) by a locally incorporated OHQ company. Although income derived from overseas sources by resident companies or by OHQ companies are exempt from income tax, dividends cannot be franked out of the shareholders as there is no Section 108 credit arising from income tax paid.

In view of the above, it is necessary to review the exemption of income granted under Section 3C by allowing dividends to be paid out of the exempt income without incurring a Section 108 charge. This should be reviewed as soon as possible so that the shareholders of the company can receive tax exempt dividends. The ability of the company to pay tax exempt dividends is certainly an incentive for resident companies to remit foreign sourced income into Malaysia, thus encouraging an inflow of foreign funds into Malaysia. In line with this review, Section 60E(5) of the Act should be re-instated so that the shareholders of the OHQ company are no worse off by the introduction of Section 3C of the Act.

Since Singapore has been comparatively successful in attracting multinational companies in setting up OHQs, Malaysia should emulate some of the benefits accorded to OHQs in Singapore. Some of the areas which can be emulated from Singapore are as follows:

- Dividends received from overseas related companies are tax exempt and no further taxes are levied when dividend income is distributed through Singapore to the parent company overseas. If the OHQ is owned by a Singapore holding company, dividends can be distributed one level upwards to the holding company exempt from further taxation. With the deletion of Section 60E(5) as mentioned above, this is not possible in Malaysia.

- Tenure of incentive ranges from 5 to 10 years. In certain instances, it is extendable beyond 10 years on meeting certain assessment criteria.

  In Malaysia, the incentive is granted for 5 years and extendable to 10 years upon fulfilling certain conditions. A fixed tenure of 5-10 years creates uncertainty whether the company should remain an OHQ on the expiration of the 5-10 years period. A fixed tenure means that the OHQ will have a short life span.

- Exemption of withholding tax on interest payments on borrowings by an OHQ from its qualifying network companies for its finance and treasury services which include central fund management.

  Malaysian OHQs can obtain credit facilities in foreign currency with the approval of Bank Negara Malaysia from non-residents to fund their treasury and fund management operations for their related companies outside Malaysia. The exemption of withholding tax on interest payments to non-residents will encourage the flow of foreign funds into Malaysia.

- Double deduction of R&D expenses allowed to be written off from taxable income arising from the R&D activities.

- No restriction on the number of expatriate posts.

  In Malaysia, the expatriate posts are based on expertise and skill requirements on approval and additional posts are considered based on organisation structure, the OHQ regional coverage and the experience and qualification of the expatriates. As obtaining of expatriate posts requires justification of the position and therefore burdensome, it has discouraged many prospective OHQ applicants in favour of Singapore.

We also note that one of the conditions for qualifying as an OHQ is that the OHQ should provide management services to at least three network companies in the region outside Malaysia. We feel that this condition should be in principle only when granting OHQ status and then enforced only after a year of operation of the OHQ so that the company has one year to establish the network companies.

Appendix VI

UNIT TRUST EXEMPTIONS

Investment in unit trusts (including property trusts) is getting popular in Malaysia in view of the relatively good and stable returns which can be derived by the investors. As the investments of unit trusts are undertaken by professional fund managers, investment in unit trusts is also relatively safe in that there are almost no risks involved. To the individual investor, it gives him the opportunity to invest in a wide portfolio of investments in that the unit trust invests in a wide range of investments which he would otherwise have to invest directly but lacks the resources to do so. Thus, to a small investor, investment in unit trusts is probably the only investment which he can undertake as the capital outlay need not be substantial.

Currently, dividends paid out by approved unit trusts are exempt from income tax in the hands of the unitholders to the extent of RM5,000 a year. Unitholders of an unapproved unit trust are taxed on dividends received from such trusts at the individual tax rate. As the RM5,000 level of exemption was determined many years ago when unit trusts were relatively new in Malaysia, it is now considered outdated in view of the growing affluence among Malaysians. To encourage savings by individuals through investment in unit trusts, it is suggested that the level of exemption for dividends paid out by approved unit trusts be increased to RM10,000. This will certainly be a boost to the unit trust industry which will then be in a position to source funds from the public to invest further.

As dividends paid out by unapproved unit trusts are not exempt from income tax in the hands of unitholders, the individual investor who may be a hardcore poor and not within the taxable range, would have to file tax returns to the Inland

Revenue Department (IRD) to obtain a refund in respect of tax deducted at source by the unit trust. Filing of tax returns and obtaining a tax refund thereon is often burdensome and time consuming for the small investor, it is suggested that exemption be granted to approved unit trusts from collecting tax on dividends at source. However, the unit trusts would have to keep proper records of the dividend distribution to the unitholders and tax certificates so that they are available to the IRD for assessment purposes where necessary.

It is also suggested that approved unit trust status be granted to those unit trusts promoted by the Government and related Government agencies such that all income (excluding dividend income) are exempted from tax. This will ensure that the income derived by the unit trust which is in turn distributed to the unitholders are tax free without having to file a tax return and apply for a refund. The exemption of income of approved unit trusts will encourage maximum participation from the public, including those from the lower income category, and provide a competitive return to the investor.

Appendix VII

REFORMS FOR WOMEN

1. **Separate Tax Forms For Married Women**
   At present, the tax system requires married female taxpayers to report their income in the Tax Return Forms of their husbands. This does not respect the confidentiality of matters and privacy of the married women within a marriage and the femme sole status of women in society. We suggest that the tax administration system be amended to allow married female taxpayers to be issued with their own tax returns separate from their husbands' returns to afford consideration to women especially in the light of their increasing participation and contribution towards the development of the country.

2. **Deductions For Working Mothers**
   Women in Malaysia enjoy equal opportunities to education and training at all levels. As a result of this policy, more and more women are joining the labour force and contributing to the development of the nation. The participation of women is indeed no longer restricted to traditional "caring" professions but encompass the whole spectrum of occupations vital for the economy. However, it is a known fact that women cannot completely abandon their maternal duties and are often prevented from joining the work force because of them. In less severe cases, women are forced to accept jobs which demand less of their time and allow them to devote some of their time to their families. Needless to say, this represents a serious loss of human capital which the nation as it moves towards 2020 can ill-afford. As it is, the nation is already feeling the strain of the tight labour situation experienced in the country currently.

   We propose changes to the income tax system which would reduce the cost to women of taking up a full-time job. In the marginal situation, this would encourage women who would otherwise stay at home to care for their children to join the nation's work force and thus maximise the utilisation of labour resources in the country. We would advocate the following reliefs against the income of the female taxpayer:-

   - Deduction for payments for the services of a maid employed to care for a child/children while the mother is at work.
   - Deduction for payments to day care centres, nurseries etc. where the child/children are cared for while the mother is at work.
   - Alternatively, an enhanced child relief given to working women could be integrated into the existing child relief to cover child-care expenditure. Such enhanced child relief has been adopted in Singapore with much success in encouraging married women to work. Such enhanced child relief could be in the form of fixed amounts for each child or a percentage of earned income of the working women.

3. **Spouse Relief**
   At present, female taxpayers whose husbands are not deriving income in the fiscal year cannot claim relief for their spouses unlike the spouse relief given to men for their wives under Section 47 of the Income Tax Act 1967. To preserve equality and fairness and in consideration of the changing values of society, we would suggest a symmetrical relief for non-working spouses of female taxpayers.

Appendix VIII

FULL DEDUCTIBILITY FOR PROFESSIONAL EXPENSES

At the moment, the Inland Revenue Department regards professional expenses such as accounting, secretarial and audit fees for investment companies as "permitted expenses" and partially allows them in the tax computations. MIA/MIT is of the opinion that the present legislation and basis for allowing the expenses may be unjust to investment companies and to some extent, organisations performing the services for such companies.

The Companies Act 1965 requires that proper books of accounts be kept, that limited liability companies engage a competent company secretary and that the books and accounts be audited by an approved company auditor. These requirements are mandatory and therefore they are necessarily incurred by the business albeit for investment purposes only. These expenses are necessary operational expenses incurred in order to carry on the business in accordance with the law.

It is unjust because the company is disallowed a substantial portion of these expenses which the law caused to be incurred and which have to be incurred if order and credibility is expected of the accounts and statutory books and other records of a properly incorporated company governed by the law. We are of the view that the statutory expenses such as these be allowed in full.

It is also not fair that professional firms particularly for accountancy practices because of the resistance from their clients to pay a decent fee for their services due to the expenses being largely disallowable for reasons beyond their control. This factor will affect professionalism.

We hope that the Minister can specifically allow full deduction for these expenses. Legal compliance is obviously needed for orderly conduct of the business in its industry and environment.

Appendix IX

SERVICE TAX OF PROFESSIONAL SERVICES IN FREE ZONES

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. Under Section 2 of the Free Zones Act 1990, it is stated that any goods and services except for those prohibited by law, brought into, taken out, produced or provided in free zones will be exempted from any customs duty, excise duty, sales tax or service tax.

Thus, based on the 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 and whose practice constitutes a prescribed professional establishment, their prescribed services are the provision of accounting, auditing, book-keeping and consultancy.

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 is based on the 'rendering of services' concept. However at a recent meeting with the Service Tax Division of the Royal Land Excise Customs Department , 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 performed is 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 is deemed not practical.

We appeal that services rendered to companies in the Free Zones should not be taxable based on the concept of 'rendering of services' as in exports which are zero rated as the intentions of the statutes for establishments in such locations is the enjoyment of tax exemption.

Appendix X

IMPROVEMENT OF ENVIRONMENT

To further enhance the Government's continuing efforts in reducing or eliminating pollution and protecting the environment, the private sector should be encouraged by the allowance of the following incentives:-

a) **Accelerated Capital Allowance for Plant and Machinery Used For Disposal of Sewerage and Industrial Effluents**

Currently, special capital allowance and import duty exemption are given to companies producing toxic and hazardous waste to encourage them to set up their own storage, treatment and disposal facilities. This incentive is restricted to toxic and hazardous waste disposal only. Manufacturing companies which produce waste that falls outside the category of toxic and hazardous waste do not benefit from the incentive although waste disposal of sewage and industrial effluents is part of the manufacturing process.

This paper seeks to expand the incentive to companies which incur capital expenditure on plant and machinery used in disposing sewage and industrial effluents by way of either an accelerated capital allowance in the form of an initial allowance of 20 per cent and an annual allowance of 40 per cent OR a reinvestment allowance in respect of the expansion and modernisation of the company's manufacturing activities.

b) Plant and Machinery of Palm Oil Mills

Outdated oil mill plant and machinery undoubtedly cause pollution to the environment. Incentives by way of either reinvestment allowance or accelerated capital allowance should be provided to encourage oil millers to modernise their operations and reduce or eliminate pollution.

Appendix XI

CAPITAL ALLOWANCES

(i) Simplifying The Rates Of Capital Allowances

The rates of annual allowances on qualifying plant and machinery are prescribed under the Income Tax (Qualifying Plant Annual Allowances) Rules 1968. The currently rates as provided in the Rules are from 6, 8, 10, 12, 14, 16 and 20 percent, depending on the type of asset and the nature of the industry. In order to simplify the calculation of capital allowances, it is proposed to reduce the classification of assets into three main categories with the following applicable rates for all industries:-

Asset	Rate (%)
Office equipment, furniture and fittings	10
Plant and Machinery (general)	15
Heavy equipment, motor vehicles and computers	20

It should be noted that under the Petroleum (Income Tax) Act, 1967, a single rate of annual allowances has been prescribed for all types of plant and machinery used in the petroleum operations.

(ii) Expensing Of Assets Costing RM 1,000 And Below

Currently, all assets, irrespective of the costs, are disallowed as revenue deductions and deductions for capital allowances are given annually based on the rate applicable to the respective assets. It is rather onerous and tedious for tax purposes to capitalise and maintain records and reconciliations of all items of assets which can be numerous and voluminous. In order to ease the burden of record keeping and to facilitate the calculation of capital allowances with a view to the introduction of self assessment, it is proposed that assets costing a certain amount say RM1,000 and below should be allowed to be written off immediately as practised in some countries such as Australia and New Zealand. The expensing of qualifying capital items costing RM1,000 and below will not involve in any overall leakage of revenue to the Government as it is merely a timing difference in the granting of the allowances. This would, however, save much time and cost to the businessmen in record keeping and in the preparation of the capital allowances schedule.

(iii) Increase Of Qualifying Expenditure For Motor Vehicles

The qualifying expenditure in respect of a motor vehicle not licensed or permitted for commercial transportation of goods or passengers is currently limited to a maximum of RM50,000. This limit is effective from the Year of Assessment 1991, when the price of a 1.6 litre to 2.0 litre car could be purchased at around RM50,000 to RM60,000. However, the price of a similar car today has increased substantially and is above RM85,000. This price is expected to increase further due to the increased cost of production and the appreciation in the Japanese yen, the Deuthschmark and the Swedish Kroner. In view of this, the maximum qualifying expenditure should be reviewed to a more realistic figure. We suggest that the limit be increased from RM50,000 to RM80,000 in the coming Budget proposal.

Appendix XII

PROPOSAL TO LIMIT BACK YEARS ASSESSMENTS TO SIX (6) YEARS

Currently, under Section 91 of the Income Tax Act 1967, back years assessments can be raised up to twelve (12) years. Officers of the Inland Revenue Department (IRD) frequently request for information up to twelve years. It is proposed that back years assessments should be restricted to within six years from the year of assessment as:-

(i) Many of the functions undertaken by the IRD have already been computerised and the overall efficiency has been increased. The computerisation and greater efficiency should enable the IRD to detect any assessment or additional assessment not raised within six years. Also, it would reduce the amount of arrears of work as all assessments and additional assessments must be raised within six years from the year of assessment.

(ii) Under the Companies Act 1965, companies are required to keep their records for seven (7) years. If information is sought by IRD officers for more than the past seven years it would be difficult and at times impossible for companies to retrieve or furnish the information. A lot of storage space is needed for companies to keep their records and it is uneconomical and not cost effective for companies to keep their records up to twelve years. Companies are penalised unnecessarily if they are unable to furnish the information requested.

(iii) Singapore has also amended their tax law in 1995 to restrict the issue of past assessments up to the last six years. In keeping with time, we feel that the proposal is justifiable as under the Malaysian Income Tax Act, 1967 claims for repayments or requests for amendment of assessments because of error or mistake are only allowed for the past six years.

Appendix XIII

PROPOSAL TO REQUIRE PAYMENT OF INTEREST FOR TAX OVERPAID BY TAXPAYERS

Under the Income Tax Act 1967, tax is due and payable on the issue of the notice of assessment. If tax is not paid within thirty (30) days of the notice of assessment, a penalty of 10% is imposed on the unpaid amount. A further penalty of 5% is imposed if the tax remains unpaid after sixty (60) days. Over and above the 15% penalty (10% + 5%) companies and taxpayers with business income are required to pay tax by bimonthly instalments, prior to the issue of the notices of

assessment. A penalty of 10% is imposed on the bimonthly instalments if tax is not paid in time i.e. within thirty (30) days. The aggregate penalty on late payment of tax could amount to 25% of the tax. Whilst these provisions will encourage taxpayers to pay their tax on time, there are unfortunately no provisions to compensate taxpayers who pay their tax which is under dispute.

It is proposed that where a taxpayer pays his tax which is under dispute to the IRD and the assessment is finally amended in taxpayer's favour, interest should be paid to the taxpayer calculated from the date when the tax was paid. If interest is paid it will encourage taxpayers to pay their tax which is under dispute and this will also reduce the amount of arrears of tax which remains unpaid every year. This proposal, if accepted, will also help to reduce the amount of standover tax which has been the subject of the Auditor General's adverse comments for a number of years. The payment of interest seems justified as the IRD has also been corporatised and with its management becoming more efficient with greater computerisation of its various functions, the calculation of and payment of interest should not pose a problem.

The proposal to pay interest should also apply to repayment cases. Repayment cases represent tax which has already been paid/deducted at source by companies declaring the dividends and when return forms are submitted by the recipients of the dividends to claim refund from the IRD, there is considerable delay in processing the repayment claim made by taxpayer. It is proposed that interest be calculated on the amount of refund due from the third month after the submission of the tax returns.

Appendix XIV

PETROLEUM (INCOME TAX) ACT, 1967

(a) Deduction for Prospecting Expenditure

Under the Income Tax Act, 1967 (ITA), Qualifying Prospecting Expenditure incurred wholly and exclusively in searching for, discovering or winning access to deposits of minerals is deductible from aggregate income as and when it is expended. If the prospecting does not abort and the mine commences production, the whole of the expenditure will be added back to income and normal mining allowances will be given.

In comparison, Qualifying Exploration Expenditure for prospecting under Petroleum (Income Tax) Act, 1967 (PITA) is capitalised and an exploration allowance is claimed over the unit-of-production method of amortisation.

It is proposed that similar to ITA, PITA should allow prospecting exploration expenditure for each field to be deducted against the aggregate income. Should the field commence to produce, then the expenditure for the field will be added back and normal exploration allowances given using the amortisation method.

(b) Deep Water Exploration/Development/Production

Accelerated depreciation should be given for deep water exploration, development and production in view of the risks faced.

(c) Tax Deduction on Abandonment Cess

Under the current Production Sharing Contract (PSC) terms, PSC contractors are obligated to contribute to an abandonment cess fund, which is used for the removal of the offshore installations when production ceases. The restoration of the offshore site is to protect the environment and to perpetuate marine ecology.

We propose that a tax deduction be specifically allowed on the contributions to the abandonment cess maintained by PETRONAS.

(d) Further Reduction of the PITA Tax Rate

Harmonising the PITA Tax Rate (40%) with the General Corporate Tax Rate (30%).

(e) Removal of Ring-Fencing Rules

Removal of ring fencing rules on each PSC tax entity.

(f) Withholding Tax

Consequent to the reduction in Sections 109 and 109B withholding rate from 15% to 10% in royalty and technical fees, the 15% withholding portion under Section 107A in respect of payments for services under a contract should similarly be reduced to 10% and the 5% withholding portion in respect of employees' taxes be removed entirely.

This should apply to both ITA and PITA.

Appendix XV

INCLUSION OF ACCOUNTANTS AS "INVESTMENT ADVISERS"

Section 2(1) of the Securities Industry Act 1983, defines an "investment adviser" as a person who carries on a business of advising others concerning securities, or issues or promulgates analyses or reports concerning securities, as part of a regular business.

It should be appreciated that accountants have extensive knowledge and experience in the profitability and compatibility of a wide range of businesses, operating in a diversity of financial environment. Advice and services that an accountant provide include investigations and reporting on the entities to be acquired; share valuation; feasibility and viability of mergers and acquisitions including the tax angle and other financial advice that is vital to the proposed transaction. Other specialist services include funding advice on capital restructuring and gearing of a company; assistance in sourcing for borrowings or equity capital; financial planning and modelling; and corporate planning.

In the light of the above, it can be viewed that an accountant is well placed to be included within the definition of "investment adviser" pursuant to Section 2(1) of the Securities Industry Act, 1983.

NOTICE

Readers are informed that Part D of the Article on Tax Planning For International Licensing And Royalty Flows will appear in the December 1995 issue.

Conference on TRANSFER PRICING

The recent 8 June 1995 occasioned the International Conference On Transfer Pricing And Multinational Enterprises, which was officiated by Y. Bhg. Dato' Iskandar Dzakurnain bin Badarudin, who sits as the Secretary to the Tax Analysis Department in the Malaysian Treasury.

The Institute, with the support of Malaysian Institute of Accountants (MIA), organised the event. Collaborating with the International Chamber of Commerce (ICC), the Institute was able to arrange a string of distinguished, foreign and local speakers to grace the conference.

En. Ahmad Mustapha presenting a token of appreciation to Y Bhg Dato' Iskandar Dzakurnain bin Badarudin.

The conference itself got off to an early start at Shangri-la Hotel, Kuala Lumpur.

After Y. Bhg. Dato' Iskandar's opening address, Mr. Martin G. Manen and Mr. G.D.Swaine begun the conference with the first session of talks. The former chaired this session whilst the latter spoke on "Transfer Pricing and Legislation in Europe, United States and Australia: Its Impact On Other Countries". In his paper, Mr. Swaine presented reviews on the recent developments and divergence between the American rules and guidelines of OECD.

Before the participants were feted to a sumptuous lunch, the floor was passed onto Ms. Daphne Yong-d'Herve, the ICC representative from Paris who gave a brief presentation of the organisation she represents.

After all 128 participants resumed their places after lunch, the representatives from Japan took over with Mr.Yuji Gomi speaking on "Transfer Pricing In Japan". This session was chaired by Mr. Junichi Fujii with Mr. Gomi delivering his account on the Japanese tax and transfer pricing methods.

The final session for the day was chaired by Mr. Eddie Chan Yean Hoe. Here, Dr.Alexander Vogele from Germany spoke on the topic of "Practical Transfer Pricing Issues: Companies Operating In the Asia-Pacific ", with emphasis on transfer pricing adjustments as well as the availability of taxation solutions.

All three sessions ended with rounds of questions and answers posed to the chairman and speaker of each respective sessions.

To mark the end of the conference, Mr. Kang Beng Hoe, the Conference Chairman, gave his closing address and thanked all speakers and participants.

Mr Kang Beng Hoe (left) explaining a point to Y Bhg. Dato' Iskandar Dzakurnain bin Badarudin (centre). On the right is President, En Ahmad Mustapha Ghazali.

Conference Chairman, Mr Kang Beng Hoe (4th from left) with conference speakers and members of the conference organising committee.

A cross-section of the participants who attended the conference.

INCOME TAX (EXEMPTION/AMENDMENT) ORDER 1995

NO	TITLE	REFER P.U. (A)	DATE GAZETTE NOTIFICATION	SUBJECT	EFFECTIVE DATE
007	Income Tax (Deduction of Insurances Premiums For Exporters) Rules 1995	079	03/23/95	For the purposes of ascertaining the adjusted income of a person from a business under the Act, there shall be allowed as a deduction any premium allowable under section 33 of the Act, payable in respect of insurance of cargo exported by the person.	
009	Income Tax (Exemption) (No. 4) Order 1995	080	03/23/95	All income of the Malaysian Commonwealth Studies Centre, Cambridge (excluding dividend income) (being funds raised from Malaysian sources, not exceeding UK 2,000,000) exempt from tax.	Y/A 1994 to Y/A 1998
010	Income Tax (Exemption) (No. 5) Order 1995	081	03/23/95	All income of the Perbadanan Perpustakaan Awam Terengganu (excluding dividend income) exempt from tax.	Y/A 1987 to Y/A 1996
011	Income Tax (Exemption) (No. 6) Order 1995	086	03/30/95	All income of the K.L International Airport Bhd (excluding dividend income) exempt from tax.	Y/A 1994 to Y/A 1998
012	Income Tax (Exemption) (No. 57) Order 1995	087	03/30/95	All income of the Malaysia-Thailand Joint Authority exempt from tax.	Y/A 1993 and subsequent Y/A
013	Petroleum (Income Tax) (Exemption) Order 1995	088	03/30/95	All income of the Malaysia-Thailand Joint Authority exempt from petroleum income tax.	Y/A 1993 and subsequent Y/A
014	Income Tax (Exemption) (No. 8) Order 1995	101	04/06/95	The Minister exempts a person resident in Malaysia who is carrying on an inbound tour Operating business, which is registered with the Ministry of Culture, Arts and Tourism from tax in respect of income derived from the business of operating group inclusive tour: Provided that this exemption shall not apply where the total number of inbound tourists from outside Malaysia on group inclusive tours is less than 500 in the basis period of Y/A.	Y/A 1993 to Y/A 2000
015	Income Tax (Exemption) (No. 9) Order 1995	108	04/13/95	Tax exemption for technical fees for an amount of US$189,476.20 of DRI/McGraw Hill receivable under an Agreement for Consultancy Services dated 1/8/95 in relation to the Malaysian Competitiveness Monitoring Systems Project.	
016	Income Tax (Exemption) (No. 10) Order 1995	109	04/13/95	Official emoluments of 14 lecturers from Northern Consortium United Kingdom who are in Malaysia for serving with the Centre of Preparatory Studies, Institut Teknologi MARA, exempt from tax.	Various Dates

NO	TITLE	REFER P.U. (A)	DATE GAZETTE NOTIFICATION	SUBJECT	EFFECTIVE DATE
017	Income Tax (Exemption) (No. 11) Order 1995	110	04/13/95	The following universities which received contract payments from Centre for Preparatory Studies, Institut Teknologi MARA, under the Cooperative Education Programme exempt from tax.	
				1. Midwest Universities Consortium for International Activities Inc.	1985 to 1989
				2. The State University of New York.	1986 to 1989
				3. University of Maryland University College.	1985 to 1987
				4. Texas International Education Consortium.	1985 to 1988
018	Income Tax (Deductions for Approved Training) (Amendment) Rules 1995	111	04/13/95	With effect from the 1st July 1993, companies that contribute to the Human Resource Development Fund (HRDF) shall not qualify for any deductions as provided under the Income Tax (Deductions for Approved Training) Rules 1992.	
019	Double Taxation Relief (The Government of The Republic of Zimbabwe) Order 1995	124	04/27/95	Agreement dated 24th January 1995 between the Government of Malaysia and the Government of the Republic of Zimbabwe for the avoidance of double taxation with respect to taxes on income.	
020	Income Tax (Exemption) (No. 12) Order 1995	137	04/20/95	The official emoluments received by the following officials for serving with the Forest Department of Sarawak exempt from tax.	
				(1) Encik Robert Butler Stuebing IPN Z4970068	1/10/94 to 30/11/94
				(2) Encik Robert Barnadas Grubh IPN M162685	23/09/94 to 09/10/94
				(3) Encik Raleigh Albert Blocu IPN Z5570344	19/10/94 to 15/12/94
				(4) Encik Svend Korsgaard IPN A002677147	29/08/94 to 31/12/94
				(5) Encik Adam Ferrie IPN EM270142	14/10/95 to 13/03/95
				(6) Encik Paul Anthony Charles Homes IPN 740033595	3/10/95 to 2/04/95
021	Income Tax (Exemption) (No. 13) Order 1995	138	05/04/95	Exemption from tax for income from the export of services outside Malaysia. The exemptions are as follows:	
				(i) 50% of the income remitted and declared by the company in its return for the Year Assessment 1993.	
				(ii) 70% of the income remitted and declared by the company in its return for the Year Assessment 1994.	

NO	TITLE	REFER P.U. (A)	DATE GAZETTE NOTIFICATION	SUBJECT	EFFECTIVE DATE
022	Income Tax (Exemption) (No. 14) Order 1995	194	06/01/95	All income of the Malaysia Airports Bhd (excluding dividend income) exempt from tax.	Y/A 1996
023	Income Tax (Exemption) (No. 15) Order 1995	211	06/08/95	The following itinerant artistes from "Suite Espanola" group who have performed in the "Spanish Week In Kuala Lumpur" exempt from tax.	
			06/08/95	(a) Ricardo Augustin Castro Romereo IPN 24237176	21/11/94 to 27/11/94
				(b) Rosario Castro Romero IPN 24230866	21/11/94 to 27/11/94
				(c) Maria Jesus Rodigues Del Ojo IPN 52332368	21/11/94 to 27/11/94
				(d) Elena Martin Maldonado IPN 02902395W	21/11/94 to 27/11/94
				(e) Jose Manuel Garcia Delgado IPN 52477805Q	21/11/94 to 27/11/94
				(f) Maria Luisa Sanchez Bustos IPN 054106396	21/11/94 to 27/11/94
				(g) Luis Rodriguez Mendes IPN 21458584K	21/11/94 to 27/11/94
				(h) Jose Dominquez Alvarez IPN 52327584H	21/11/94 to 27/11/94
				(i) Francisco Lopez Saez IPN 00244779	21/11/94 to 27/11/94
				(j) Jose Ramon Salazar Bustos IPN 5233268	21/11/94 to 27/11/94
024	Income Tax (Exemption) (No. 16) Order 1995	212	06/08/95	The official emoluments received by the following officials for serving with the Forest Department of Sarawak, exempt from tax.	
				(a) Mr. Raleigh Albert Blouch IPN Z5570344	16/12/94 to 30/12/94
				(b) Mr. Svend Korsgaard IPN A002677147	13/02/94 to 13/03/95
025	Income Tax (Exemption) (No. 17) Order 1995	213	06/08/95	Tax exemption up to maximum RM580,000 for small and medium scale companies in respect of monies received by way of grant from the Industrial Technical Assistance Fund (ITAF) from the 1st August 1990.	
026	Income Tax (Exemption) (No. 18) Order 1995	218	06/08/95	All income of the Sabah Sports and Cultural Board (excluding dividend income) exempt from tax.	Y/A 1982 to Y/A 1996
027	Double Taxation Relief (The Government of New Zealand) Order 1995	225	06/22/95	Second Protocol to the Agreement dated 23/05/95 between the Government of Malaysia and the Government of New Zealand for avoidance of Double Taxation and the prevention of fiscal evasion with respect to income taxes.	
028	Income Tax (Deduction for Freight Charges) Rules 1995	229	06/25/95	Any freight charges incurred by a person, provided that such freight charges were paid to a Malaysian incorporated shipping for transportation on board a Malaysian Ship shall be allowed as a deduction.	Y/A 1994 to seubsequent Y/A

Interest Restriction - The End Of A Nightmare -

CHOONG KWAI FATT
TAX LECTURER, UNIVERSITY OF MALAYA

INTRODUCTION

The Inland Revenue Department (IRD) had issued guidelines on 16 July 1990 relating to the interest restriction under section 33(2) and interest allowable under section 33(1) of the Income Tax Act 1967 (The Act).

The computation of interest restriction can be very complicated and time consuming in situations where the company has a large investment portfolio, comprising of shares, landed premises and deposits, advance to subsidiaries etc. This is because the guidelines expressly require the investment sources (*rental, shares, deposits*) to be broken down into income-producing and non income-producing source; and within income producing sources, it will then be further broken down into various sub-groups.

A majority of taxpayers have used the guidelines to finalise tax computations or to have the exempt income account agreed upon for declaring exempt dividend purposes. Taxpayers generally have found the guidelines tedious and requiring heavy documentation with a great deal of time being spent reconciling interest balances. This has increased the cost of doing business in Malaysia especially for the investment holding company.

On 21 July 1994, a Special Commissioners case **P securities Sdn Bhd v DGIR** (1995)(2 MSTC 2256) has decided that there can only be one investment source income and this contradicts the tax authorities' guidelines to split the investment source into income-producing and non income-producing source.

This article will examine the treatment of interest restriction before the P Securities' case and also assess the impact of the case on future interest restriction problems.

THE POSITION UNDER THE INCOME TAX ACT 1967

Interest expense will be allowed as a deduction if the expense was wholly and exclusively incurred on money borrowed employed in the production of gross income or laid out on asset used or asset held for the production of gross income. [section 33(1)(a)]

The deductibility under sec 33(1)(a) is further subjected to interest restriction under sec 33(2). Where a company has used a portion of the loan, which has been borrowed for business purposes for re-lending or investment in movable or immovable properties, then the deductibility of interest expense in order to arrive at business adjusted income/loss will be restricted.

The amount of interest restricted will be calculated using the formula :

$$\text{Interest expense to be restricted} = \frac{\text{Total investment}}{\text{Total borrowings}} \times \text{Monthly Interest expense}$$

The computation is done on a monthly basis and the monthly interest is deemed to accrue evenly over the period. [sec 33(2)(a)]

THE IRD GUIDELINES ISSUED ON 16 JULY 1990

The pertinent features of the IRD guidelines were observed as follows:-

(1) Non applicability of interest restriction

Where interest on borrowed money charged to the business account does not exceed RM10,000 for companies and RM6,000 for individuals, sec 33(2) will not apply and the full interest expense will be allowed against the business income.

(2) Formula under sec 33(2)

The computation of interest restricted will be as follows:-

Investment	Not exceeding RM500,000	Exceeding RM500,000
Balance of Interest expense to be used for calculation	End of year balances	Strictly month end balances

(3) Allocation of interest restricted against Investment income

The amount of interest restricted for business purposes

will be allowed against the investment income. However, under the guidelines, the interest to be allowed against the investment income is further subjected to the following scrutiny:-

(a) Loans

Investment in respect of loans will be split into "income producing" and non income-producing" groups and the interest applicable to the income-producing investments will be deducted against interest income from those investments.

As such, interest applicable to the non income producing investment will be lost.

(b) Shares

Investment in the form of portfolio shares (other than subsidiaries and associates) should be divided into "income-producing" and "non income-producing" groups and the interest applicable to the income producing investments will be deducted against dividend income from those investments.

As such, interest applicable to the non income-producing investment will be permanently lost. This is because only business losses can be setoff against non business source and the unabsorbed losses can be carried forward to future years of assessment. Under the Act, no relief is given in respect of investment losses.

Each investment in a subsidiary or associate company is to be treated as a separate source. If the subsidiary/ associate does not yield dividend income or low dividend income, the interest expense applicable to it will also be permanently lost.

The above treatment is summarised as follows:-

Type of Shares	Portfolio shares	(other than associates & subsidiaries)	Associates	Subsidiaries
Classifications	Income producing (IP)	Non Income producing (NIP)	each investment is a separate source	each investment is a separate source
Treatment	Portfolio - IP	Portfolio - NIP	Source by source	Source by source

(c) Landed Properties

Landed properties will be grouped according to their usage i.e. shophouses, factories and business premises will be grouped to form a single source whilst houses or flats will be grouped to form a separate source.

Based on the guidelines, it is clearly shown that the company is required to account for the monthly balances of the interest expense account, as well as to keep track of the subdivision of the investment source. For a listed company, interest restriction calculation would be laborious if it owns 10 subsidiaries, 20 associate companies, advances given to subsidiary/associate company with/without interest charges and numbers of landed properties coupled with a few sources of borrowings.

The issues would be further complicated if a subsidiary turns into an associate, associate company has become simple investment or vice versa. This nightmare will not only cause loading on the company staff, tax agent as well as the tax authorities personnel spending countless days tracing the transaction trail and also to verify the interest restriction calculation.

P SECURITIES SDN BHD V DGIR (1995) 2 MSTC 2256 - THE END OF A NIGHTMARE

The decision of this case is a welcome one. In this case, the taxpayer is an investment company, holding investments in shares, some of which produced income in the form of dividends every year ever since there were purchased by the company while others did not.

In order to acquire those investment shares, the taxpayer borrowed money from financial institutions and interest of various amounts was incurred by the company during the periods under consideration. It is not disputed that the interest was incurred in the production of income.

For the relevant periods, the company was assessed to income tax on dividends received on the ground that each counter of share investment constituted a separate source of income. Consequently, interest deduction was apportioned between income producing counters and non income producing counters.

The company appealed arguing that all the counters of share investment of the company formed a single source of income. Therefore, the whole of interest payable applicable to all the counters of investment for those basis periods should be set-off against the share investment income for those periods, irrespective whether some of the counters of the shares investment were not producing dividend income in those periods.

The issue to be determined by the Special Commissioners of Income Tax is whether each counter of shares investment held by the company as investment holding company, constituted a single or separate source of income within the meaning of sec 33(1) of the Act, read together with sec 4(c) for the purpose of ascertaining the adjusted income of the company.

The determination of one source or separate source is an important issue because this would affect:-

(a) the extensiveness of documentation to be kept by the company. If the separation is needed, then the company has to keep track between income producing counters and non income producing counters for all of its investment sources. The status of the counters could vary from year to year and this would further add on to the complexity.

(b) The amount of tax payable by the company can be drastically affected from year to year, depending on whether the investment counter is income producing or non income producing during the year in question. The interest expense to be set off against investment income will also fluctuate from year to year.

Example:

Tan Lee Mey Bhd is an investment holding company, holding shares in listed companies which do not exceed 20% of the share capital of each counter. The total investment is as follows:-

Portfolio shares	Investment	Dividend received (Grossed)
	RM	RM
Income producing counters	6m	300,000
Non income producing counters	4m	-

All investment is financed through borrowings from Hong Leong Bank. The total interest expense incurred during the year amounted to RM120,000. Assuming the interest expense is allocated using year end balances (Note : in actual calculation, the IRD would require the interest restrictions to be determined based on month end balances), then the interest allocation to the portfolio shares would be as follows:-

Portfolio shares	Investment	Interest expense (Grossed)
	RM	RM
Income producing counters	6m	72,000
Non income producing counters	4m	48,000

The tax computation

Each counter is a separate source		All counters constitute one source	
Dividend income:-			
Income Producing	300,000	Dividend Income	300,000
Less: interest	(72,000)	Less: interest	(120,000)
Adjusted income	228,000	Adjusted income	180,000
Non income producing	-		
Total income	228,000		180,000
Tax payable @30%	68,400		54,000

If all counters of investment are to be treated as one source, it would result in a tax saving of RM14,400. In addition to that, there would not be any voluminous paper work.

Back to the case of P Securities, the company also argued that sec 4(c) is restricted to dividend being one source and does not envisage that the source could be further categorized into groups: income producing shares and non income producing shares. If it is so then the wording would have been akin to sec 43 where in references to "business" there can be several sources.

The Special Commissioners decided that:-

(1) On the true and proper construction of sec 33(1) and for the purpose of sec 4(c) of the Act, each counter of shares investment does not constitute a separate source of income; and

(2) pursuant to that as dividend is the only source of income of the company, it is erroneous for the tax authorities to apportion the interest payable on the loan to acquire the shares investment between the counters that produce dividend income and the counters that do not produce dividend income.

The decision of the case is following the ratio dedidenci by Rowlatt J in the UK case of **Merrifield v The Wallpaper Manufacturing Ltd** (1931) 16 TC 40 . The case concerns whether the income in the form of interest from two different securities i.e. National War Bonds and War Loan stock, should be treated as income from one source or from separate sources for the purpose of Case III, Schedule D of the UK Income Tax Act 1918. Rowlatt J decided that it would be a single source. His Lordship's comments (page 43)

" ....The Income Tax Acts are a tax upon the yearly profit and gains of the subject, and among the yearly profits and gains, upon interest on money, and the whole field of yearly profits and gains is split up and sub-divided for the purposes of different methods of charging, different methods of assessment, and so on; but it seems to me that, ***the tax being in the first instance upon profit and gains, one ought not to disintegrate the grouping of the profits and gains according to the sources, further than the Acts affirmatively required.....***"

THE POSITION AFTER P SECURITIES SDN BHD V DGIR

At the point of writing, the IRD had stated during the Dialogue between the IRD and MIA, MACPA, MIT and MATA held on 25 February 1995 that the P Securities case is currently under appeal and until the outcome is known, the existing guidelines issued by IRD on 16 July 1990 should be followed.

CONCLUSION

Since losses arising from investment sources such as rental, dividend and interest income cannot be carried forward nor utilized against other income, it would not be necessary to further sub-divide each investment source into income producing and non income producing groups. After all, this is not catered for by the Act. Using the words of the learned Rowlatt J." one ought not to disintegrate the groupings of the profits and gains according to sources, further than the Acts affirmatively required."

Malaysian Institute Of Taxation

The Assessability Of Rental Income As A Business Source

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INTRODUCTION

The assessability of rental income as business income under sec 4(a) or rental income under sec 4(d) is always a very important issue. However, there is no express provision under the Income Tax Act 1967 (ITA) which specifically deals with this issue, neither were there any guidelines formulated by the tax authorities until recently.

Traditionally, the taxpayer may seek judicial guidance from the Privy Council case, ALB Co Sdn Bhd v DGIR (1979) 1 MLJ 1 but the tax authorities have their own internal guidelines for such determination. This has caused lengthy disputes between taxpayers and the tax authorities and resulted in loss of time and money. As a result, representations had always been made by professional bodies to urge the tax authorities to formulate guidelines.

On 25 May 1995, the Inland Revenue Department (IRD) issued a circular stating various scenarios for determination of rental income to be assessed as business income. However, the circular seems to contradict with a recent Special Commissioners case, GDPD Factory Sdn Bhd v DGIR (1995) 2 MSTC 2264 which was decided on 19 August 1994.

This article attempts to reconcile the differences between the circular and the GDPD case. It also examines the ALB case as well as two other Special Commissioners' cases heard in relation to the determination of assessability of rental income as business income under sec 4(a).

THE IMPORTANCE TO DISTINGUISH BETWEEN SEC 4(a) AND SEC 4(d)

Section 4(a) is always advantageous as compared to Sec 4(d) because it accords the following merits under the ITA:-

(a) Basis Period

Income in the nature of business under Sec 4(a) is assessed on a financial year basis [sec 21(2)] while rental income is assessed on a calendar year basis [sec 21(1)]. With appropriate tax planning, this basis of assessment can be advantageous to the taxpayer.

(b) Capital Allowances

Where a company is recognized as carrying on a business of letting property, it would be entitled to claim capital allowances on the capital expenditure incurred on the equipment and lifts installed in the building. The rates ranges from 2% to 20% and capital allowance calculated will be used to shield the adjusted income from rental. Any unabsorbed capital allowances will be carried forward indefinitely to future years of assessment to setoff against the adjusted income from any business source.

The claim of capital allowance is not available for sec 4(d) on capital expenditure incurred on the equipment and lifts installed in the building. However, industrial building allowance would be available in both sec 4(a) or 4(d) source if the building is rented out for industrial purposes.

(c) Expenses

The company, whether assessed under sec 4(a) or sec 4(d), is entitled to claim as a deduction against gross rental income, all revenue expenditure wholly and exclusively incurred.

However, for a sec 4(a) source, expenditure would be allowed as a deduction so long it was incurred in that period but the gross income need not be produced in that period. It would be absurd to tie each expenditure to see what income is produced and when, following the decision in Vallambrosa Rubber Co Ltd v Farmer (5 TC 529)

(d) Losses

Any losses incurred for sec 4(a) income would be available for set off against income from another business source or income from non business sources of the same financial year; while the excess can be carried forward to future years of assessment to be utilised against future income from any business source.

For sec 4(d) income, any losses incurred in the same calendar year would be a permanent loss. There is NO relief to allow such losses to be set off against income from business source or income from non business source of the same calendar year. In short, unabsorbed losses for sec 4(d) income are never available as tax deductions.

(e) Investment Holding Company (IHC) - Section 60F of ITA

The concept of IHC was introduced in the 1993 Finance Act 497 and took effect from year of assessment 1993. Sec 60(F)(2) defines IHC as a company whose activities consist wholly in the making of investments and whose income is derived therefrom.

If a company is categorized as an IHC, rental income will be treated as investment income and it would be subject to the restriction over the deductibility of expenses under sec 60(F). In general, only a maximum of 25% of expenses would be allowed as a deduction against its investment income.

In contrast to a non IHC company, the expenses allowed would be 100%, so as long it satisfies the wholly and exclusively test as laid down by sec 33 of ITA.

A REVIEW OF THE LATEST SPECIAL COMMISSIONERS CASE
GDPD FACTORY SDN BHD V DGIR (1995) 2 MSTC 2264

This case was concerned with the issue of whether the rents received from the letting out of the taxpayer's building (factory building) constituted income from a business within the meaning of section 4(a) or rental income under section 4(d) of the ITA.

In that case, the taxpayer was a company incorporated on 14 August 1970 with a wide variety of objects which included the selling and letting out of movable and immovable property of all kinds in particular land, buildings etc. The initial business of the taxpayer was a cloth printing and dyeing material company.

The taxpayer had a building which was utilised as a factory building for its batik printing and dyeing business. It commenced business on 30 September 1970 and ceased operations on 1 September 1972. It started letting out the factory building in 1978 to A-Co and subsequently to B-Co. The unabsorbed losses brought forward from year of assessment 1978 amounted to RM49,212.

The taxpayer argued that the rental income received from the letting out of the factory building should be 4(a) source because the company was incorporated for the purpose of making profit for its shareholders. Any gainful use to which it puts any of its assets prima facie amounts to the carrying on of a business.

However, the tax authorities contended that the word "business" connotes a continuous and active business operation. In this case, there was a lull period, a period of no business activity for about 6 years and what the taxpayer did after that was just letting out the building in the capacity of an ordinary property owner. The letting out of the property in such circumstances could not be construed to be a normal business operation and consequently, the income received therefrom was not income from a business or from a source consisting of a business. The said income therefrom was assessed to income tax under section 4(d) of the Act.

Nevertheless, the Special Commissioners concluded that the rent received by the taxpayer from the letting of the factory building was income from a business under section 4(a) of the ITA. The decision in GDPD v DGIR was reached relying on the principle enunciated in the Privy Council case of ALB Co Sdn Bhd v DGIR (1979) 1 MLJ 1

In ALB, the company ceased its tobacco manufacturing business and commenced a new business of letting out the warehouse and factory. The tax authorities argued that the company was not carrying on a business of renting, therefore the rental income should be assessed to tax as investment income under section 4(d) of the ITA. However, the Privy Council held that rents received therefrom are assessable to income tax under section 4(a) and not section 4(d).

The learned judge Lord Diplock had drawn the contrast between a private individual whose mere receipt of rents from the property he owns raises no presumption that he is carrying on a business and a company incorporated for the purpose of making profits, which is prima facie carrying on a business where it makes gainful use of its property by letting it out for rent. This presumption is only rebutted upon evidence admitted to court.

The Judge further explained that the rent despite the fact that it is referred to in paragraph (d) of sec 4, may nevertheless constitute income from a source consisting of a business if it is receivable in the course of carrying on a business of putting the taxpayer's property to profitable use by letting it out for rent.

Where premises are let in the course of carrying on the business of putting them to profitable use, sec 43(1) gives primacy to the classification of the rents receivable as income from a source consisting of business, notwithstanding that they may also be classified under sec 4(d) as rents. What sec 43(1) requires is that one should first determine whether the rents are income from a business. If they are, no further enquiry is needed; adjusted losses from a business of the taxpayer for previous years of assessment are deductible in ascertaining the taxpayer's aggregate income.

Back to the GDPD case, the Special Commissioners also rejected the tax authorities' contention that "business" means a continuous and active commercial operation. Although the taxpayers business was inactive for about six years, it would still be regarded as business. There is nowhere in the ITA stating that the word "business" means only "continuous business activity or operation".

Lord Diplock has stated in the ALB case that " the carrying on of business, no doubt, usually calls for some activity on the part of whoever carries it on, though, depending on the nature of the business, the activity may be intermittent with long intervals of quiescence in between".

THE CASE BEFORE GDPD

Before the GDPD case, there were two other cases heard before the Special Commissioners on the issue of assessability of the rental income as business income under section 4(a). They are :-

(a) KW Enterprise Sdn Bhd v DGIR (1989) 1 MSTC 361

(b) H Holdings (M) Sdn Bhd v DGIR (1989) 1 MSTC 385

In the KW case, it was held that the rental income derived from two rented premises was a sec 4(d) source because there was clear admission of evidence that the rents were investment income. The case of ALB is distinguishable from the KW case. In ALB, the company completely abandoned its tobacco business and commenced a completely new business i.e. the business of renting out its property. In the KW case, the company improved on its auto spare parts business each year and did not abandon it; to say that the company has commenced a new business as alleged by the evidence was unthinkable in view of its annual turnover sales. The question whether there is a business or no business in the letting of the premises is a question of fact and law, thus, the Special Commissioners are entitled to make inferences from the facts.

One year later, in the case of H Holding, the Special Commissioners had ruled that the company was carrying on a rental business under sec 4(a). There was sufficient evidence admitted that the company was carrying on the business of letting out property. The standard of proof required by the company was on the balance of probabilities and not beyond reasonable doubt.

In reaching the decision, the Special Commissioners rejected the KW case as an authority for deciding the issue of assessability of rental income and relied on the ALB case. Following the decision in the ALB case, it is easier to establish that a company is conducting a business due to the fact that any gainful use to which it puts any of its assets, prima facie, amounts to the carrying on of a business. In view that the tax authorities had failed to rebut the evidence admitted by the company, thus the company was carrying on a business of letting properties and therefore assessable under sec 4(a). In this case, there are 8 properties comprised of shophouses and residential units.

After reading the three Special Commissioners' cases and the Privy Council case of ALB, one may reach the conclusion that a company by putting its property to gainful use prima facie amounts to carrying on of a business. *The onus is on the tax authorities to rebut this prima facie inference.* The determination of whether there is a business or no business in the letting of the premises is a question of fact and law for the Special Commissioners to decide as they are entitled to make reasonable inference from the facts.

In order to sustain a business source argument, it would be advisable for the company to carry out active activities such as provide amenities or furnishing to tenants, advertise to invite tenants, regularly maintain and inspect the premises as well as employ professionals to carry out the management aspects of the renting and impute charges for such services provided. In short, the company must be able to demonstrate its active involvement and commitment in a substantial degree in the activity of renting.

THE IRD CIRCULAR ISSUED ON 25 MAY 1995

The circular issued by the IRD is to assist companies to determine whether rental income received should be assessed as a sec 4(a) or sec 4(d) source. This is a welcome move which has been long awaited but unfortunately, it does not seem to put the dispute to rest.

Following the circular, rental income will be assessed as business income under the following scenarios :-

Category	1	2	3
Type of Property	Commercial Building	Shop houses	Residential houses/ Apartment/Condominium
No of units	3	2	4
(Minimum)	Total area not less than 92.9 meter square/ 1000 feet square	Situated in commercial area	- it must not be rented out to directors/ staff . - Premises must be in good maintenance.

For the mixture between category 1/2/3, if the total units for each category is less than that stated above, then rentals received would be assessed as sec 4(d) source. Four examples have been given in that circular, which are tabulated below :-

Type of Property	Commercial Building	Shop houses	Residential houses/ Apartment/ Condominium	Assessment Sec. 4 (a)/4(d)
No of Units				
Example				
A	1	1	3	4(d)
B	1	1	4	4(a)
C	3	-	1	4(a)
D	1	2	1	4(a)

The IRD circular seems to impose a quantitative test for the determination of rental income as sec 4(a) source. The focus for the determination is on the quantity of units owned by the company and not on the activities carried out by the company in order to determine whether a business is carried on or not.

THE EXISTENCE OF BUSINESS SOURCE: ACTIVITY TEST OR QUANTITY TEST?

In my opinion, the crucial test for the determination of whether business exists or not lies in the activity carried out by the company. It should and would never depend on the number of units owned. If a company maintains its properties in good repair at all time, advertises for tenants, negotiates with tenants whenever there are vacant properties to be let, attends to complaints by tenants, collects rentals and does its best to ensure maximum rental from the letting, this would clearly demonstrate that a business is carried on EVEN THOUGH the company had only ONE office building.

This is clearly in line with the principles laid down by the Learned Judge, Lord Diplock in the PC case, ALB v DGIR. The ratio decidendi of ALB has been subsequently adopted in *all the three Special Commissioners cases in* KW case, H Holding and the GDPD case.

For the interest of readers, I tabulated the number of units or properties and the decisions in all the above cases decided:-

	ALB v DGIR	KW Enterprise v DGIR	H Holdings (M) v DGIR	GDPD v DGIR
Year	1978 - PC	1988 -SC	1989 - SC	1995 - SC
Decision	4(a) source	4(d) source	4(a) source	4(a) source
No of units - Properties	1 factory building	2 shophouses	a mixture of 8 residential units, shophouses and vacant land	1 factory building

The decisions reached in all of the above cases were based solely on the activity test and nothing was mentioned on the quantity of premises owned by the company.

CONCLUSION

The guidelines issued by the IRD apply a quantitative test which appears to be in conflict with the rationale underlying the decisions in the cases mentioned above. I believe that whether a company is said to be carrying on a business of renting is a question of fact and depends solely on the activities carried out by the company. The number of units of property may provide an indicating factor of carrying on a business but it definitely cannot be a conclusive criterion.

NOTICE

Please be informed that the Institute is currently seeking further clarification on the circular issued by IRD on 25 May 1995 pertaining to Section 4 (a) and 4 (d) of the Income Tax Act.

Pertukaran Pegawai-Pegawai Kanan Jabatan Kastam dan Eksais DiRaja Malaysia

1. Connie Teoh Kok Hong
   Ketua Pasukan Pembangunan Sistem (Cukai Dalaman),
   Penolong Kanan Pengarah Kastam,
   Sistem Maklumat Pengurusan,
   Ibu Pejabat.

2. Lee Ah Yem @ Le Cheng Geok
   Penolong Kanan Pengarah Kastam,
   Cawangan Pemeriksaan Akaun,
   Wilayah Persekutuan.

3. Moideen b. Ahmad
   Penolong Pengarah Kastam,
   Imort/Eksport,
   Ipoh, Perak.

4. Jamaludin b. Omar Ali
   Penolong Pengarah Kastam,
   Lumut (LMT),
   Perak.

5. Abdullah Zawawi b. Abdul Latif
   Penolong Pengarah Kastam,
   Khidmat Sokongan,
   Bahagian Pencagahan,
   Ibu Pejabat.

6. Shaharuddin b. Ibrahim
   Penolong Pengarah Kastam,
   Cukai Dalaman,
   Negeri Sembilan.

7. Ali b. Baba
   Penolong Pengarah Kastam,
   Cawangan Cukai Jualan,
   Wilayah Persekutuan.

8. Mokhtiar Bibi bt. Sher Mohamad
   Penolong Pengarah Kastam,
   Zon Bebas/Gudang Pengilangan Berlesen,
   Ibu Pejabat.

9. Abdullah b Hashim,
   Penolong Pengarah Kastam,
   Cukai Perkhidmatan,
   Ibu Pejabat.

10. Haji Shuib b. Haji Salleh
    Penolong Pengarah Kastam,
    Melaka.

11. Fatimah bt Kamari
    Penolong Pengarah kastam,
    Cukai Jualan
    Ibu Pejabat.

12. Mohd. Suffian b. Damanhuri
    Penolong Pengarah Kastam,
    Import/Eksport,
    Ibu Pejabat.

Interest Allowed Against All Investment

RAYUAN NO. PKR 495

EXECUTIVE SUMMARY

RAYUAN NO. PKR 495
P.SECURITIES SDN BHD LWN KETUA PENGARAH HASIL DALAM NEGERI

FACTS

The Appellant was an investment holding company whose principal activity since 1974 consisted of holding investments in shares. Some shares produced income every year while others did not. All the shares were acquired with interest-bearing loans. For the year of assessment 1979, 1980 and 1981, the Appellant was assessed to tax on the dividend income under section 4(C) of the Income Tax Act 1967. For the purpose of the assessments, the shares were segregated into income-producing and non income-producing shares with interest deduction being calculated only in respect of the former.

ARGUMENTS

The Appellant claimed that it had only one source of income i.e. shares and that therefore the whole of the interest on loans used in the purchase of shares should be deductible, regardless of whether some of those shares did not produce dividend income. There was only one source of income although there may be investment in several counters of shares.

The Revenue contended that each of the counters of share investment of the Appellant constituted a separate source of income and accordingly the interest deductions should be apportioned between the income-producing and non income-producing counters of the share investment.

HELD

The Appellant had only one source of income i.e. dividend. Each counter of share investments does not constitute source of income. Therefore it is erroneous to apportion interest payable on the loans between income-producing and non income-producing shares. The Income Tax Act 1967 having grouped the categories of income under paragraphs (a) to (f) of section 4, it is improper and erroneous to further subdivide the source by treating each counter of share investment as a separate source further than affirmatively required by the Act. The assessments should therefore be amended to take into account the whole interest payable on the loans for the years concerned.

1. At the meeting of the Special Commissioners of Income Tax held at Kuala Lumpur on 10 April 1993 and 29 July 1993, the Appellant PS Sdn Bhd appealed against the assessments made by the Jabatan Hasil Dalam Negeri for the Years of Assessments 1979, 1980 and 1981 on the disallowance of interest on loans obtained by the Appellant in the purchase of investments shares under sec. 4(c) of the Income Tax Act 1967. In computing the adjusted income of the Appellant for the relevant years of assessment under sec. 33(1) of the Act, the Respondent treated each counter of share investment as a separate source of income and consequently interest deduction was apportioned between the income producing counter and the non-income producing counter of share investments.

2. The issue for the determination of the Special Commissioners is whether each counter of share investment held by the Appellant as an investment holding company constitutes a single or separate source of income within the meaning of sec. 33(1) of the Income Tax Act.

3. En NS bin MN, an advocate and solicitor appeared for the Appellant, and was assisted by Puan KL, Tax Manager, KC & Associates. The Respondent was represented by Puan PK, peguam kanan persekutuan, Jabatan Hasil Dalam Negeri.

4. The following documents were tendered at the hearing :

Exhibit A - Agreed Statement of Facts;

Exhibit B - Appellant's submission;

Exhibit C - Respondent's submission;

Exhibit D - Appellant's Reply.

5. The following authorities were cited by the contending parties:

The Appellant

DGIR v. ALB Co. Sdn Bhd (1950-1985) MSTC 33; (1974) M.L.J. 76.

Cape Brandy Syndicate v CIR 12 T.C. 366.

Merrifield v. The Wallpaper Manufacturers Ltd 16 T.C. 40

Diggines v. Forestal Land Timber Railways Co. Ltd. 15 T.C. 630.

RE Sdn Bhd v. DGIR (1950-1985) MSTC 64; (1984) 1 M.L.J. 1.

The Respondent

RE Sdn Bhd v. DGIR (1950-1985) MSTC 64; (1984) 1 M.L.J. 1.

Scales v. George Thompson & Co. 13 T.C. 83.

CIR v. Lever Brothers & Unilever Ltd. (1946) 14 S.A.T.C 1.

F.C. of T. v. United Aircraft Corporation (1943) 7 A.T.D. 31.

Hart (H.M. Inspector of Taxes) v. Sangster 37 T.C. 231.

6. The facts of the case as agreed are as stated in para. 2 of the Grounds of Decision.

7. No witnesses were examined and the hearing was confined to the agreed facts.

8. The Appellant contends that there is only one source of income although there are several counters of shares investment and accordingly interest deductions should not be apportioned between the income producing and the non-income producing shares investment.

9. It is the Respondent's contention that each of the counters of share investments of the Appellant constitutes a separate source of income, and accordingly the interest deductions should be apportioned between the income-producing counter and the non-income producing counter of the shares investment.

10. We gave our decision in the Deciding Order dated 21 July 1994 whereby we held that "tiap-tiap satu kaunter of share investment tidak menjadi suatu source yang berasingan bagi maksud seksyen 4(c) Akta Cukai Pendapatan 1967" and the Order is exhibited at p. 20.

11. The Respondent is aggrieved by the decision of the Special Commissioners and has requisitioned the Special Commissioners to state a case for the opinion of the High Court.

12. The question for the opinion of the High Court is whether on the facts agreed, the decision is correct in law.

Grounds of decision

1. This is an appeal by PS Sdn Bhd against the assessments made for Years of Assessments 1979, 1980 and 1981 vide Notices of Assessment dated 21 May 1981, 8 October 1982 and 8 October 1984 respectively.

2. The agreed facts of this case are as follows:

PS Sdn Bhd ("the Appellant") was incorporated on 20 August 1971 with wide objects, one of which was "to acquire and hold shares for investment or resale and to traffic in shares." It is also authorised to invest in land and deal with moneys not immediately required.

By an Extraordinary General Meeting of the Appellant held on 3 April 1974, the object cl. 3(1) was amended to read as follows:

> "3(1) To carry on the business of an investment company and for that purpose to acquire and hold either in the name of the Company or in that of any nominee shares, stocks, debentures, debenture stocks, bonds, obligations and securities issued or guaranteed by any company or private undertaking or any syndicate of persons constituted or carrying on business in Malaysia or elsewhere and debentures, debenture stocks, bonds, obligations and securities issued or guaranteed by any Government, sovereign ruler, commissioners, public body or authority supreme, local or otherwise and to acquire and such shares, stocks, debentures, debenture stocks, bonds, obligations, transfer, exchange or otherwise and to exercise and generally to enforce and exercise all rights and powers conferred by or incidental to the ownership thereof."

3. The principal activity carried on by the Appellant since 1974 consisted of holding of investment in shares, some of which produced income in the form of dividends every year ever since they were purchased by the Appellant while others did not.

4. During the periods 1 February 1977 to 31 January 1978 (Year of Assessment 1979), 1 February 1978 to 31 January 1979 (Year of Assessment 1980) and 1 February 1979 to 31 January 1980 (Year of Assessment 1981) the Appellant's investment in shares, both income-producing and the non-income producing, were as follows:

Basis Period (Year of Assessment)	Total Investment (RM)
(i) 1.2.77 to 31.1.78 (YA 1979)	200,091,158 (see Appendix A1)
(ii) 1.2.78 to 31.1.79 (YA 1980)	192,514,325 (see Appendix B1)
(iii) 1.2.79 to 31.1.80 (YA 1981)	184,511,820 (see Appendix C1)

5. For the purpose of acquiring those investment shares, the Appellant borrowed money from financial institutions and interest of various amounts were incurred by the Appellant during the periods under consideration. It is not disputed that the interests were incurred in the production of income.

6. The Schedules of shares purchased, the interest incurred and the amount of dividend received in respect of those shares, during the period under consideration are tabulated in Appendices A1, B1 and C1.

7. It is the Respondent's contention that as the Appellant is an investment company the dividend income received is assessable under sec. 4(c) of the Income Tax Act and each of the counters of share investment of the Appellant, constitutes a separate source of income. Accordingly for the Years of Assessment 1979, 1980, 1981 the Appellant was assessed to income tax on dividends received in the relevant basis periods under sec. 4(c) of the Act as per Computation of Repayment, on the ground that each of the counter of share investment constitutes a separate source of income, and consequently interest deduction was apportioned between the income-producing counters and the non-income producing counters of share investments.

8. The Appellant was aggrieved by the treatment adopted by the Respondent and appealed on the ground that all the counters of share investment of the Appellant formed a single source of income. Therefore, the Appellant contends that the whole of the interest applicable to all the counters of investment for those basis periods should be set-off against the total share investment income for those periods, irrespective of whether some of the counters of the share investments were not producing dividend income in

those basis periods.

9. The Appellant raised objection against the Computations of Repayments for the Years of Assessment 1979, 1980 and 1981 and Notices of Appeal to the Special Commissioners of Income Tax (Forms Qs) were lodged with the Respondent.

10. The main question for determination by the Special Commissioners of Income Tax is whether each counter of shares investment held by the Appellant as an investment holding company, constitutes a single or separate source of income within the meaning of sec. 33(1) of the Act.

CONTENTIONS

It was contended by the Appellant, as in his written submission marked "B', that the assessment were erroneous because:

(a) the use of the nomenclature "counters of investment" does not have the force of the law and the Respondent is in error when he treated each counter of shares investment as being a separate source;

(b) the Respondent had apportioned the interest payable between the income-producing and the non-income producing counters of shares investment which is not authorised by the Act. By apportioning the Respondent had treated the shares investment as being separate sources which is not the intention of sec. 4(c) of the Act.

It is the Appellant's contention that sec. 4(c) is restricted to dividend being a source and does not envisage that that source could be further categorised into groups: income-producing and the non-income producing share. If it was so then the wording would have been akin to sec. 43 where in reference to "business" there can be several sources.

The Appellant quoted the following cases in support of his contention:

(1) ALB Co. Sdn Bhd v. DGIR (1950-1985) MSTC 33; (1974) M.L.J. 76.

(2) Cape Brandy Syndicate v. CIR 12. T.C. 366.

(3) Merrifield v. The Wallpaper Manufacturing Ltd 16 T.C. 40.

(4) Diggines v. Forestal Land, Timber & Railway Co. Ltd 15. T.C. 630.

It was contended by the Respondent, as in his written submission marked "C" that the assessments are correct because:

(a) On the true construction of sec. 33(1) all the various counters of shares investment form separate sources of income.

(b) Like business where there can be several sources so too shares investment whose sources are the several counters of the shares investment.

The Respondent quoted the following cases in support of his contention:

(a) RE Sdn Bhd v. DGIR (1950-1985) MSTC 64; (1984) 1 M.L.J. 1.

(b) Scales v. George Thompson & Co. 13 T.C. 83.

(c) CIR v. Lever Brothers & Unilever Ltd (1946) 14 S.A.T.C. 1.

(d) F.C. of T. v. United Aircraft Corporation (1943) 7. A.T.D. 31.

(e) Hart (H.M. Inspector of Taxes) v. Sangster 37 T.C. 231.

DECISION

I. The background of the appeal again

(1) It is an agreed fact that the Appellant is an investment holding company whose principle activity since 1974 consisted of holding investment in shares, some of which produced income in the form of dividend every year since they were purchased by the Appellant, while others did not.

(2) The Appellant was assessed under sec. 4(c) of the Income Tax Act 1967.

(3) All of shares were acquired with loans on which interest is payable.

(4) In computing the adjusted income of the Appellant for the Years of Assessment 1979, 1980 and 1981 under sec. 33(1) of the Act the Respondent segregated the shares into income-producing shares counters and so interest deduction was apportioned between income-producing counters and non-income producing counters of shares investment.

(5) By sec. 33(1) of the Income Tax Act 1967, the Appellant claims that interest is deductible from the profits if it has been wholly and exclusively incurred in the production of income. The Appellant therefore claims deductions from the dividend income received from the said shares investment the whole of the interest applicable to the aforesaid loans used in the purchase of the shares, regardless of whether some of those shares did not produce dividend income.

(6) The Appellant therefore disagreed with the Respondent's treatment contending there is only one source of income although there may be several counters of shares investment and accordingly interest deductions should not be apportioned between income-producing and non-income producing shares investment.

(7) The Respondent remained steadfast and hence this appeal.

II. The issue

2. The issue for determination in this case is therefore whether the Respondent is correct in his interpretation that each counter of shares investment held by the Appellant as an investment holding company constitutes separate source of income within the meaning of sec. 33(1)(a) read together

with sec. 4(c) of the Income Tax Act 1967, for the purpose of ascertaining the adjusted income of the Appellant. If all the counters of shares investment taken together do not form a single source of income the whole interest applicable to the loans taken by the Appellant to finance the purchase of the share investment would not qualify for deduction in computing the profits of the Appellant company for tax purposes. The determination of this issue therefore depends on our determination of the word "source" as appearing in sec. 33(1) of the Act.

III. Reasoning

3. Section 2 of the Income Tax Act 1967 defines the word "source" to mean merely "source of income". However this scanty definition only gives rise to a further question: what is meant by "source of income". The Respondent contends that we are not dealing with the meaning of "source of income" in the ordinary sense of the word but with a source of income for income tax purposes.

(1) As this definition is grossly inadequate to and as no useful assistance could be found in the Act (except for the word business) it is necessary to look at the scheme of the Act in relation to this word "source". Section 33(1) in relation to "source" reads:

> "Subject to this Act, the adjusted income of a person from a source for the basis period for a year of assessment shall be an amount ascertained by deducting from the gross income of that person from that source for that period all outgoings and expenses wholly and exclusively incurred during that period by that person in the production of gross income from that source, including -
>
> (a) subject to subsection (2), any sum payable for that period (or for any part of that period) by way of interest upon any money borrowed by that person and -
>
> (i) employed in that period in the production of gross income from that source; or
>
> (ii) laid out on assets used or held in that period for the production of gross income from that source."

(2) And as the Appellant was assessed under sec. 4(c) it is imperative that the examples itemised in sec. 4 be considered in our effort to determine the meaning of the word. Section 4 reads -

> "4. Subject to this Act, income upon which tax is chargeable under this Act is income in respect of -
>
> (a) gains or profits from a business, for whatever period of time carried on;
>
> (b) gains or profits from an employment;
>
> (c) dividends, interest or discounts;
>
> (d) rents, royalties or premiums;
>
> (e) pensions, annuities or other periodical payments not falling under any of the foregoing paragraphs;
>
> (f) gains of profits not falling under any of the foregoing paragraphs."

(3) Thus business is a source of income in sec. 4(a) and employment in sec. 4(b). However for 4(c), 4(d), 4(e) and 4(f) the law does not prescribe the sources. But since the Appellant was assessed on the dividends received from his shares investment under sec. 4(c) it is conceded therefore that the shares investment is the source in respect of the Appellant's income. And he was assessed accordingly.

4. The issue remained to be determined is whether each counter of the said shares represents a source or whether all the shares taken together represent the source.

(1) What is a "counter of investment". As this phrase was not defined in either of the submissions, especially so in the Respondents', for it was the Respondent who raised the issue, we called for further submission on this point.

(2) The Respondent replied as in Exh. "E" which is "istilah counter of share investment adalah bermaksud pelbagai saham atau stok yang diperolehi oleh syarikat berkenaan, contohnya PS Sdn Bhd mempunyai saham-saham syarikat seperti yang disenaraikan di dalam Appendix A1, B1 dan C1 kepada Statement of Agreed Facts. Tiap-tiap satunya adalah satu counter of share-investment." By this it would mean every share or stock of shares of a company held by the Appellant is a counter and each counter is a source.

(3) The Appellant replied as follows: "istilah 'counter of share investment' yang diguna oleh kami adalah bermakna saham-saham di dalam sesuatu syarikat. Misalnya saham-saham Syarikat PSD Sdn Bhd (lihat Appendix A1, dalam Statement of Agreed Facts) adalah satu 'counter of share investment'. Begitu juga saham-

saham syarikat lain yang disenaraikan di dalam Appendix A1, B1 dan C1 kepada 'Statement of Agreed Fact' adalah tiap-tiap satunya satu 'counter of share investment'."

5. Thus from the definitions given the Appellant does not dispute the interpretation given by the Respondent as regards this phrase. However the Appellant still disputes that each counter constitutes a separate source because of these reasons:

(a) The Act does not prescribe that there may be several sources from employment nor for dividend, interest or rent. Section 33 is silent on that. But in respect of businesses it is different. Section 43 has clearly provided, for it and this interpretation can be found in the Privy Councils decision in **RE Sdn Bhd v. DGIR**. Two other cases are cited in support they are **Merrifield v. The Wallpaper Manufacturing Ltd** and **Diggines v. Forestal Land Timber and Railways Co. Ltd.**

(b) So much reliance was placed by the Respondent in the case of **RE Sdn Bhd v. DGIR**. However we find as the issue in the above case was in respect of business i.e. whether the Appellant was carrying a single business or several businesses of plantation/estate the issue there is a different kettle of fish. In the case before us the issue as agreed is the dividend of shares investment by an investment holding company and therefore that case is irrelevant for our consideration. As regards business one merely has to look at sec. 43 of the Act to realise that it is possible to have more than one source consisting of business.

(1) Perhaps the nearest analogy is the case cited by the Appellant i.e. **Merrifield v. The Wallpaper Manufacturers Ltd 16 T.C. 40**. In that case, one of the issues was whether the income in the form of interest from two different securities i.e. National War Bonds and War Loan Stock, should be treated as income from one source or from separate sources for the purpose of Case III, Schedule D of the U.K. Income Tax Act 1918. The General Commissioners held that interest from the two securities should be assessed as income from the same source. On appeal to the High Court, Rowlatt J. took the view that once the Act has sub-divided the profits and gains which are subject to tax one ought not to disintegrate groupings of the profits and gains according to sources further than the Acts affirmatively require. His Lordship's statement reflecting the above appears at p. 43 of the report and reads as follows:

"Now it seems to me that in approaching that question one ought to approach it in this way: The Income Tax Acts are a tax upon the yearly profits and gains of the subject, and among the yearly profits and gains, upon interest on money, and the whole field of yearly profits and gains is split up and sub-divided for the purposes of different methods of charging, different methods of assessment, and so on; but it seems to me that, the tax being in the first instance upon profits and gains, one ought not to disintegrate the groupings of the profits and gains according to sources, further than the Acts affirmatively require. I think the idea that really underlies the decision of the House of Lords in the **Forestal** case is that when you find a thing grouped in one, you are not to sub-divide it further unless there is some reason for it."

Further, at p. 44 of the Report, Rowlatt J. stated:

"Then when one comes on to the securities issued under the War Loan Acts, I do not find any authority for splitting that up. I go back to what I started with. You are taxing interest, and what you are saying is 'interest from various sources', and the Act says 'interest from any securities under the War Loan Acts'. That interest is the subject-matter of the taxation, interest from securities under certain number of Acts. Well, there it is; that is the subject-matter of taxation, and I do not see any affirmative justification or any positive authority for saying that that means the several sums which you get from several investments which can comprehensively be described as being covered by this group of Acts of Parliament. I think the **Forestal Land** case gives great guidance in this matter, and on the grounds that I have expressed, I come to the conclusion that this appeal ought to be dismissed with costs."

(2) In our view, **Merrifield**'s case provides a useful analogy to the Appellant's case. Although **Merrifield**'s case deals with interest whereas in the Appellant's case we are dealing with dividend, the general schemes of taxation under the U.K. law and ours are comparable - the difference being that in our case the taxable income are grouped under separate paragraphs under sec. 4 while under the U.K. law, they are grouped under five schedules i.e. Sch. A, B, C, D and E, each containing complete rules for each class of income. Despite the difference, the general principle which can be derived from the decision in this case is applicable because in both cases the question was whether the income (i.e. interest in **Merrifield**'s case and dividend in Appellant's case) could be treated as income from the same or separate sources.

6. As can be seen from **Merrifield**'s case it was held that interest payments were treated as coming from the same source although they were received by the appellant company from separate investments (securities).

7. In the House of Lord's case **Diggines v. Forestal Land, Timber and Railways Co. Ltd 15 T.C. 630**, the **Forestal Land** case referred to by **Rowlatt** J. above, the point at issue as clearly put by Lord Warringtom of Clyffe at p. 653

of the report, was whether, as the Respondent (the Company) maintained, the assessment should be made upon the footing that each holding of shares was a separate source of income separately assessable, or, as the Crown contends, the assessment for each year should be arrived at by treating the full amount of the dividends as arising from one source of income only. The House of Lords reversed the decisions of the Commissioners and the courts below, and held that the contention of the Crown was correct, i.e. the dividends should be treated as arising from one source of income only.

8. It is therefore submitted that the same reasoning as in **Merrifield**'s case can be applied in the Appellant's case here in that the Income Tax Act 1967 having grouped the categories of income which are subject to tax under several groups as prescribed under para. (a) to (f) of sec. 4 of the Act, which had already been discussed and classified as sources of income for tax purposes, it is improper and erroneous for the DGIR to further sub-divide each source by treating each counter of share investments as a separate source. This is so because, to use the words of Rowlatt J. one ought not to disintegrate the groupings according to sources further than the Acts affirmatively require. To treat each counter of share investment as a separate source is without doubt to disintegrate the grouping further than that which is authorised by the Income Tax Act 1967.

9. In the result it is our determination that:

(1) On the true and proper construction of sec. 33(1) and for the purpose of sec. 4(c) of the Income Tax Act 1967 each counter of shares investment does not constitute a separate source of income; and

(2) pursuant to that as dividend is the only source of income of the Appellant company it is erroneous for the Respondent to apportion the interest payable on the loan to acquire the shares investment between the counters that produce the dividend and the counters that do not produce the dividend.

10. For the above reasons, we order that the appeal by the Appellant be allowed and that interest should not be apportioned between the counters that produce the dividend from the counter that do not produce the dividend and that the Notices of Assessment for the Years of Assessment 1979 dated 21 May 1981, for the Year of Assessment 1980 dated 8 October 1982 and for the Year of Assessment 1981 dated 8 October 1984 be amended and full deductions be given to the whole interest payable on the loans for the Years concerned.

PERINTAH KEPUTUSAN

RAYUAN INI yang telah dibicarakan pada 10 April 1993 dan 29 Julai 1993 dengan kehadiran En NS bin MN peguamcara dan peguambela bagi pihak Pihak Perayu dan Puan KS, peguam kanan persekutuan, Jabatan Hasil Dalam Negeri, bagi pihak Pihak Responden.

DAN SETELAH MENDENGAR PIHAK PERAYU DAN PIHAK RESPONDEN ADALAH DIPUTUSKAN BAHAWA:

(1) menurut tafsiran yang patut dan munasabah bagi Seksyen 33(1) dan bagi maksud Seksyen 4(c) Akta Cukai Pendapatan 1967 tiap-tiap satu counter of shares investment tidak menjadi suatu source yang berasingan; dan

(2) menyusul dari itu oleh kerana dividen adalah satu-satunya source pendapatan Pihak Perayu maka adalah satu kesilapan undang-undang bagi Pihak Responden mengasingkan feadah yang kena dibayar keatas pinjaman untuk membeli saham-saham pelaburan itu dari counter yang menghasilkan dividen dengan counter yang tidak menghasilkan dividen.

DAN ADALAH DIPERINTAHKAN BAHAWA RAYUAN INI DIBENARKAN DAN NOTIS-NOTIS TAKSIRAN Bagi Tahun-Tahun Taksiran 1979, 1980 dan 1981 masing-masing bertarikh 21 Mei 1981, 8 Oktober 1982 dan 8 Oktober 1984 hendaklah dipinda untuk mengambil kira semua faedah yang telah dikenakan keatas pinjaman untuk membeli saham pelaburan Pihak Perayu tanpahirau suatu counter itu telah mendatangkan dividen atau pun tidak.

[This appeal was heard on 10 April 1993 and 29 July 1993 in the presence of Mr. NS bin MN, advocate and solicitor for the Appellant and Puan KS, Senior Federal Counsel, Inland Revenue Department, for the Respondent.]

AND AFTER HEARING BOTH PARTIES IT IS DECIDED THAT:

(1) On the true and proper construction of sec. 33(1) and for the purpose of sec. 4(c) of the Income Tax Act 1967 each counter of shares investment does not constitute a separate source of income; and

(2) pursuant to that as dividend is the only source of income of the Appellant company it is erroneous for the Respondent to apportion the interest payable on the loan to acquire the shares investment between the counters that produce the dividend and the counters that do not produce the dividend.

AND IT IS ORDERED THAT THIS APPEAL BE ALLOWED AND THE NOTICES OF ASSESSMENT for Years of Assessment 1979, 1980 and 1981 dated 21 May 1981, 8 October 1982 dan 8 October 1985 be amended to take into account all the whole interest payable on the loans for the Years concerned.]

Dated 21 July 1994.

Signed
Pengerusi,
Pesuruhjaya Khas Cukai Pendapatan

Signed
Pesuruhjaya Khas Cukai Pendapatan

Signed
Pesuruhjaya Khas Cukai Pendapatan

Malaysian Institute Of Taxation

RENTAL CAN BE BUSINESS INCOME

RAYUAN NO. PKR 561

EXECUTIVE SUMMARY

RAYUAN NO. PKR 561
GDPD FACTORY SDN BHD V. KPHDN

FACTS

The Appellant company was from the outset, a printing and dyeing cloth material company. The business commenced on 30 September 1970 and ceased on 1 September 1972. The company owned a building which was utilised as a factory until the cessation of its business of batik printing. For the period 1973 to 1977, there was no business activity. Thereafter, from December 1978, the company started letting out the factory building. The Memorandum and Articles of Association of the company included purchasing and selling property and also letting out moveable and immovable property of all kinds. Business losses of RM49,212 were brought forward from the year of assessment 1978.

Rents accrued in the year 1978 to 1980 were subjected to section 4(d) of the Income Tax Act 1967 as rental income. The Appellant did not appeal against this treatment. However, the Appellant appealed against the assessment for the years of assessment 1983 to 1987 claiming that the income from letting out the factory building constituted income from business under section 4(a) of the Act and that therefore the losses brought forward should be deductible.

ARGUMENTS

The Appellant contended that its Memorandum and Articles of Association gave it the authority to deal with its property in whatever way profitable to its shareholders. The case is on all fours with the decision in ALB Co. Sdn Bhd v. Director General of Inland Revenue (1950-1985)(MSTC 33; (1979) 1. MLJ. 1.). The Appellant being a company is formed to make profits for its shareholders and any gainful use to which it puts its assets *prima facie* amounts to carrying on of a business. The period of "no business activity" from 1973 to 1977 does not affect the case as the Act does not restrict "business" to mean continuous business activity.

The Respondent contended that there is no board resolution or tenancy agreement to show the change of business. Pure letting out in the capacity of a landowner does not constitute a normal business activity. Although there is a *prima facie* presumption in favour of the Appellant as stated in the ALB case, the latter is not an authority for any rental received. The fact that the Appellant did not appeal against the tax treatment of the rental income for the years 1978 to 1980 amounts to an admission that the rents were rental income under section 4(d) of the Act.

HELD

The Special Commissioners decided that the rents received for the relevant years of assessment constituted income from a business. Consequently, the adjusted losses brought forward from the year of assessment 1978 should be deducted against the business income of the Appellant. The appeal was allowed and the assessments discharged.

1. At a hearing of the Special Commissioners of Income Tax held in Kuala Lumpur on 12 and 18 August 1994: GDPD Factory Sdn Bhd (the Appellant) appealed against the Pemberitahu Taksiran Tahun Taksiran 1983 Borang J(1) C.862248-05 bertarikh 7 May 1983, Notis Taksiran Tambahan Tahun Taksiran 1983 Borang JA(1) C.0862248-05 bertarikh 6 October 1988, Notis Taksiran Tahun Taksiran 1985 Borang, J(1) C.0862248-05 bertarikh 6 October 1988, Notis Taksiran Tahun Taksiran 1985 Borang J(1) C.0862248-05 bertarikh 6 October 1988, Notis Taksiran Tahun Taksiran 1986 Borang J(1) C.0862248-05 bertarikh 6 October 1988, Notis Taksiran Tambahan Tahun Taksiran 1987 Borang JA(1)C.862248-05 bertarikh 6 October 1988 showing altogether, a total sum of RM26,370.45 as tax payable for those years of assessment, made by the Director General of Inland Revenue (the Respondent).

2. Shortly stated the question for our determination was whether the rents received from the letting out of the Appellant's building (factory building) constituted income from a business within the meaning of sec. 4(a) of the Income Tax Act 1967 or rental income under sec. 4(d) of the same Act.

3. Encik T, an advocate and solicitor appeared for the Appellant and Encik A Senior Federal Counsel appeared for the Respondent. Both the Appellant and the Respondent did not call any witnesses.

4. The following documents were tendered in evidence at the hearing:

   (a) Agreed Bundle of Documents -- P1

   (b) Statement of Agreed Facts -- P2

   (c) Respondent's Bundle of Documents -- P3

5. As a result of the agreed documentary evidence tendered to us, we find the following facts proved or admitted.

   (A) Facts Admitted

   (1) The Appellant herein, GDPD Factory Sdn Bhd ("the Company") was incorporated on 14 August 1970 under the Companies Act 1965 as a company limited by shares.

   (2) The Appellant's registered office is at 1st Floor/ Room 4, ABC Building, No.67, Jalan A, Kuala Lumpur and it has a place of business at 6th Floor No. 12, Jalan S.B., 57100 Kuala Lumpur.

   (3) The authorised capital of the Appellant is RM200,000 divided into 200,000 shares of RM1 each. The amount of capital paid up or credited as paid presently is RM102,000 consisting of 102,000 shares of RM1 each.

   (4) The Appellant has, from the outset been a printing and dyeing cloth material company.

(5) The Appellant has a factory building situated at No. 1501, M Road, Nibong Tebal, Province Wellesley.

(6) The Appellant was utilising the said building as a factory prior to the cessation of its business of batik printing.

(7) Thereafter, on or around 31 December 1978 the factory building was let out.

(8) Prior to this the Appellant sustained losses as shown in the accounts.

(9) The losses were brought forward from the Year of Assessment 1978 amounting to RM49,212.

(B) Facts Found from the Admitted Documents

(1) The objects of the Appellant as listed in its Memorandum and Articles of Association specifically in para.3(1)(6) and (45) are, inter alia, purchasing and letting out moveable and immovable property of all kinds, in particular lands, building, hereditaments etc.

(2) The Appellant commenced its batik printing and dyeing business and used its factory building on 30 September 1970 and the said business ceased operations on 1 September 1972.

(3) The Appellant started letting out its factory building in December 1978, first to T Trading Sdn Bhd 1501, M Road, Nibong Tebal, and subsequently to M L Rubber Trading Sdn Bhd, 1501, M Road, Nibong Tebal.

6. It was contended on behalf of the Appellant that the said rents constituted income from a business within the meaning of sec. 4(a) of the Income Tax Act I967 on the grounds that:

(i) Under its Memorandum and Articles of Association the Appellant is given the authority to deal with its property in whatever way profitable to its shareholders. So it started with the batik printing business and later put the factory building to profitable use by letting it out for rent.

(ii) The case is on all fours with the decision in ALB Co. Sdn Bhd v. Director General of Inland Revenue (1950-1985) MSTC 33; (1979) 1 M.L.J. 1.

(iii) The Appellant is a company formed to make profits for its shareholders and is not an individual. Any gainful use to which it puts any of its assets prima facie amounts to carrying on of a business.

(iv) The period of "no business activity" from 1973 to 1977 does not affect the case because there is no provision in the Act which restricts the word "business" only to mean continuous business activity throughout the period the Company is in existence.

7. It was contended on behalf of the Respondent that the rents constituted rental income under sec. 4(d) of the Income Tax Act 1967 for the following reasons:

(i) There is no evidence by way of a Board resolution or tenancy agreement to show the change of business, i.e. from batik printing to letting out;

(ii) "Business" means a continuous and active commercial operation. Pure letting out in the capacity as a land owner does not constitute a normal business activity;

(iii) Although there is a prima facie presumption in favour of the Appellant as stated in the ALB Co. Sdn Bhd v. Director General of Inland Revenue (1950-1985) MSTC 33; (1979) 1 M.L.J. 1, the latter is not an authority for any rental received;

(iv) The rents accrued in the years 1978, 1979 and 1980 were subjected to sec.4(d) of the Income Tax Act 1967. The fact that the Appellant did not appeal against such a treatment amounts to an admission that they were rental income under sec. 4(d) of the said Act.

8. We were referred to the following authorities:

(i) ALB Co. Sdn Bhd v. Director General of Inland Revenue (1950-1985) MSTC 33; (1979) 1 M.L.J. 1.

(ii) RE Sdn Bhd v. Director General of Inland Revenue (1950-1985) MSTC 64; (1981) 1 M.L.J. 99.

(iii) DEF v. The Comptroller of Income Tax (1950-1985) MSTC 482; (1961) M.L.J. 55.

(iv) E v. Comptroller-General of Inland Revenue (1950-1985) MSTC 106; (1970:, 2 M.L.J. 117.

(v) II Ltd v. Comptroller-General of Inland Revenue (1950-1985) MSTC 38; (1979) 1 M.L.J. 4.

(vi) SR Co. Ltd v. Director General of Inland Revenue (1950-1985) MSTC 416; (1980) 2 M.L.J. 198.

(vii) LFY Sdn Bhd v. Comptroller-General Inland Revenue (1988) 1 MSTC 3,059; (1986)2 M.L.J. 161.

(viii) Words and Phrases Legally Defined 2nd Ed. Vol. 1 A-C p. 199.

(ix) Dilworth & Ors v. The Commissioners of Stamps, D & O v. The Commissioner for Land and Income Tax (1899) A.C. 99.

(x) South Behar Railway Co. Ltd v. Commissioners of Inland Revenue (1925) A.C. 476.

(xi) Carr v. Inland Revenue Commissioners (1944) 2 All E.R. 163.

(xii) Commissioner of Inland Revenue v. Marine Steam Turbine Co. Ltd (1920) 1 K.B. 193.

(xiii) Commissioner of Income Tax v. Hanover Agencies Ltd (1967) All E.R. 954.

(xiv) Sharikat K.M. Bhd v. The Director General of Inland Revenue (1950-1985) MSTC 332; (1972) 1 M.L.J. 224.

(xv) EK Sdn Bhd v. Director General of Inland Revenue (1950-1985) MSTC 403; (1977) 2 M.L.J. 263.

(xvi) Gittos v. Barclay (Inspector of Taxes) (1982) S.T.C. 390.

(xvii) Griffiths (Inspector of Taxes) v. Jackson and Griffiths (Inspector of Taxes) v. Pearman (1983) S.T.C. 184.

(xviii) The Law and Practice of Income Tax 7th Ed. by Kanga and Phalkhivala's.

(ix) Narain Swadeshi Weaving Mills v. Commissioners of Excess Profits Tax (1954) Vol. 26 I.T.R. 765.

(xx) Commissioner of Income Tax v. Universal Plast Ltd(1992) Vol.197 I.T.R. 1

(xxi) Harry Walsh and Archie Robert Micay v. Minister of National Revenue 65 D.T.C. 5293.

(xxii) Smithers Plaza Ltd (Appellant) v. The Minister of National Revenue (Respondent) 75 D.T.C. 137.

(xxiii) Her Majesty the Queen (Appellant) v. Marsh & McLennan Ltd (Respondent) 83 D.T.C.5180.

(xxiv) Ensite Limited (Appellant) v. Her Majesty The Queen (Respondent) 86 D.T.C. 6521.

(xxv) Canadian Marconi Co. (Appellant) v. Her Majesty the Queen (Respondent) 86 D.T.C.6526.

9. We, the Special Commissioners who heard the appeal took time to consider our decision and gave it on 19 August 1994 for the following reasons.

The issue for determination in this appeal is whether the rents received from the letting out of the Appellant's building (the factory building) for the relevant years of assessment constituted income from a business within the meaning of sec. 4(a) of the Income Tax Act 1967 or rental income under sec. 4(d) of the same Act. The Income Tax Act 1967 is hereinafter referred to as "the Act".

The Appellant was incorporated on 14 August 1970 with an authorised capital of RM200,000 divided into 200,000 shares of RM1 each, and having its registered office at 1st Floor/Room 4, ABC Building, No. 67, Jalan A, Kuala Lumpur, and its place of business at 6th Floor, No. 12, Jalan S.B., Kuala Lumpur.

The objects for which it was established as set out in its Memorandum and Articles of Association consist of a wide variety of business activities including, inter alia, mining, smelting, construction, printing, purchasing and selling property and also letting out movable and immovable property of all kinds, in particular, lands, buildings, hereditaments etc.

The Appellant had, from the outset, been a printing and dyeing cloth material company. It had a building which was utilised as a factory building for its batik printing and dyeing business at No. 1501, M Road, Nibong Tebal, Province Wellesley. It commenced its batik printing and dyeing business on 30 September 1970 and the said business ceased operations on 1 September 1972. It started letting out the factory building in December 1978, first to T Trading Sdn Bhd, Nibong Tebal and subsequently to M L Rubber Trading Sdn Bhd Nibong Tebal.

The Appellant sustained losses of RM49,212 which were brought forward from the year of assessment 1978.

The Appellant contended that the rental income should have been assessed to income under sec.4(a) of the Act on the grounds that the letting out of the factory building from which the taxable income was derived was a business activity as it was performed in the course of carrying on the profitable use.

The Respondent contended that the word "business" connotes a continuous and active business operation. However, in this case there was a lull period, a period of no business activity for about six years and what the Appellant did after that was just letting out the building in the capacity of an ordinary property owner. The letting out of the property in such circumstances could not be construed to be a normal business operation and consequently the income received therefrom was not income from a business or from a source consisting of a business. The said income tax under sec.4(d) of the Act.

The onus of proving that an assessment against which an appeal is made is excessive or erroneous is on the Appellant (para.13 of Sch. 5 of the Act). In order to succeed in the Appeal the Appellant has to prove that the rents were income received from a business or from a source consisting of a business so as to bring himself within the ambit of the section.

For ease of reference we produce sec.4 of the Act which reads as follows:

"A. Subject to this Act, the income upon which tax is chargeable under this Act is income in respect of-

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

(b) gains or profits from an employment;

(c) dividends, interest or discounts;

(d) rents, royalties or premiums;

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

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

It is first necessary to determine the meaning of the word "business" which is defined in sec. 2 of the Act as follows:

" 'business' includes profession, vocation and trade and every manufacture, adventure or concern in the nature of trade, but excludes employment."

In support of his argument the Appellant mainly relied on the decision of the Privy Council in **ALB Co. Sdn Bhd v. Director-General of Inland Revenue (1950-1985) MSTC 33; (1979) 1 M.L.J. 1 (ALB)** which was adopted by the Federal Court in **RE Sdn Bhd v. Director General of Inland Revenue (1950-1985) MSTC 64; (1984) 1 M.L.J. 104 (RE)**. In the ALB case the Appellant was incorporated with the principal object of cutting and blending tobacco and manufacturing cigarettes. Like the Memorandum and Articles of Association of the Appellant on this case, the ALB's Memorandum and Articles of Association incorporated a variety of objects including granting licences over and generally dealing with land rights and other property of the Company. It purchased land whereon it erected a building which contained a factory and a bonded warehouse for storage purposes. The tobacco business of the company proved to be unprofitable and had accumulated adjusted losses and was eventually discontinued. With the abandonment of trading in tobacco the Company no longer needed to make use of the building itself and so it let it out intermittently to few companies to use and occupy for storage purposes. The issue that arose in that case whether the income received from the letting out was income from a business under sec.4(a) or rental income under sec.4(d) of the Act. The Director-General of Inland Revenue maintained that the classes of income should fall under sec.4 were mutually exclusive and that the income should fall under sec.4(d) of the Act while the Appellant contended that it should fall under sec.4(a) of the Act. The Special Commissioners, on appeal, held in favour of the Appellant. At the request of the Director-General of Inland Revenue the Special Commissioners stated a case for the opinion of the High Court which upheld their decision. The decision of the High Court was reversed by the Federal Court. However the Privy Council restored the decision of the Special Commissioners. In delivering the advice of the Board Lord Diplock said at pp. 2-3:

"If the words in the various paragraphs of section 4 of the Malaysian Act are: given their ordinary meaning -- and their Lordships see no reason why they should not be - there is plainly room for overlapping between one paragraph and another. A company may carry on business as an investment or holding company deriving its gains or profits from dividends and interest from the securities it owns. The gains or profit from the business of a bank or moneylender are largely derived from interest received on money lent. A property company or an individual may be carrying on the business of letting premises for rents from which the pains or profits of that business are derived.

That there is potential overlapping between paragraph (a) and paragraphs (c) and (d) is, in their Lordships' view, put beyond doubt by the provisions of section 24. The general rule laid down in sections 27 and 28 is that income other than income from a business does not become chargeable until it has actually been received. By section 27(1) this is applied specifically to 'rent'. The purpose of section 24 is to provide as an exception to the general rule that on computing chargeable income from a business book debts arising in the period of assessment shall be brought into account although not actually received. Sub-sections (4) and (5) apply this exception to dividends and interest on securities held by investment companies and interest receivable in the course of carrying on a business of lending money; while sub-section (1)(c) applies the same exception inter alia to debts arising 'in respect of ... (c) the use or enjoyment of any property dealt with at any time in the course of carrying on a business.

So it is clear that 'rents', despite the fact that they are referred to in paragraph (d) of section 4, may nevertheless constitute income from a source consisting of a business if they are receivable in the course of carrying on a business of putting the taxpayer's property to profitable use by letting it out for rent.

Where premises are let in the course of carrying on the business of putting them to profitable use, section 43(1) in their Lordships' view gives primacy to the classification of the rents receivable as income from a source consisting of a business, notwithstanding that they may also be classified under section 4(d) as 'rents'."

Useful guidance in resolving the problem posed in the case before us is provided by Lord Diplock in the ALB case at p. 3 in the following terse terms:

"In the case of a private individual it may well be that the mere receipts of rents from property that he owns raises no presumption that he is carrying on a business. In contrast, in their Lordships' view, in the case of a company incorporated for the purpose of making profits for its shareholders any gainful use to which it puts any of its assets prima facie amounts to the carrying on of a business. Where the gainful use to which a company's property is put is letting it out for rent, their Lordships

do not find it easy to envisage circumstances that are likely to arise in practice which would displace the prima facie inference that in doing so it was carrying on a business."

The presumption that arises when a company lets out its premises for rent was emphasised in clear terms by the Privy Council again in **II Ltd v. Comptroller General of Inland Revenue (1950-1985) MSTC 38; (1979) 1 M.L.J. 4** where 'Viscount Dilhorne in delivering the advice of the Board said at p. 5:

"In the very recent case of **ALB Co. Sdn Bhd v. Director-General of Inland Revenue (1950-1985) MSTC 33; (1979) 1 M.L.J. 1** where the advice of this Board was delivered by Lord Diplock, attention was drawn to the contrast between a private individual, whose mere receipt of rents from property that he owns raises no presumption that he is carrying on a business, and a company incorporated for the purposes of making profits, which is prima facie carrying on a business where it makes gainful use of its property by letting it out for rent."

In this appeal there is no dispute that the Appellant is not an individual but a Company incorporated for the purpose of making profits for its shareholders. It put the factory building to gainful use by letting it out on rent. In accordance with the principle enunciated in the ALB decision this prima facie amounts to the carrying on of a business. The onus is on the Respondent to rebut this prima facie inference.

They did not tender any documentary evidence to rebut the presumption that arose against them. In his submission learned Senior Federal Counsel rightly conceded that there is a prima facie presumption in favour of the Appellants but added that the said case "... is not an authority for any rental received." The point raised by learned Senior Federal Counsel is devoid of any merits and is incomprehensible. The cases that we have referred to expressly refer to the receipt of rental. It is ludicrous to suggest that the presumption applies to the letting out of premises and not to the rental received. The rental received is the result of the letting out of the premises. The Income Tax Act is only concerned with the result of an operation and not the act of the operation itself. Thus the Respondent has failed to rebut the presumption. In the RE case too there was no evidence to rebut the prima facie inference and with regard to the failure to do so Lee Hun Hoe C.J.(Borneo) said at p. 104:

"On the evidence there is only one conclusion of fact on the ALB case that any reasonable Commissioner would reach, viz., there is no evidence to rebut the prima facie inference that during the relevant periods of assessment appellant was carrying on a business of letting out its premises for rent. Hence the Privy Council allowed the appeal by setting aside the order of the High Court in affirming the decision of the Commissioners."

We interpolate to add that the Respondent was in no position to rebut the presumption as he did not call any witnesses and, furthermore, he deprived himself of the opportunity of cross-examining the Appellant's witnesses by agreeing to the Appellant's documents as evidence which enabled the Appellant not to expose his witnesses to cross-examination -a strategic move, perhaps.

With respect to the contention of the Respondent that "business" means a continuous and active commercial operation we are of the view that no such restriction or qualification has been imposed on the word by the Act. This argument was raised by the Respondent to demolish the claim made by the Appellant on the ground that the premises were not put to any use for a certain period. Nowhere does the Act say that the word "business" means only "continuous business activity or operation". Thus the Act cannot be construed as contended by the Respondent. In this respect we can do no better than refer to Maxwell on The Interpretation of Statutes, London 1969, p. 256:

"Statutes which impose pecuniary burdens are subject to the same rule of strict construction. It is a well-settled rule of law that all charges upon the subject must be imposed by clear and unambiguous language, because in some degree they operate as penalties: the subject is not to be taxed unless the language of the statute clearly imposes the obligation, (see **Russel v. Scott (1948) A.C. 422, per Lord Simonds; D'Avigdor v. I.R.C. (1953) A.C. 347**)), and language must not be strained in order to tax a transaction which, had the legislature thought of it, would have been covered by appropriate words. (See **I.R.C. v. Wolfson (1949) 1 All E.R. 865, per Lord Simonds**). 'In a taxing Act,' said Rowlatt J., 'one has to look merely at what is clearly said. There is no room for any intendment, there is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used.'(See **Cape Brandy Syndicate v. I.R.C. (1921) 1 K.B. 64, p. 71**, approved by Viscount Simon L.C. in **Canadian Eagle Oil Co. Ltd v. R (1946) A.C. 119**)."

We find support for our view that the period of "no activity" is not relevant in the ALB case where Lord Diplock said at p.3:

"The carrying on of 'business', no doubt usually calls for some activity on the part of whoever carries it on, though, depending on the nature of the business, the activity may be intermittent with long intervals of quiescence in between."

Reference may also be made to **South Behar Railway Co. Ltd v. Commissioners of Inland Revenue (1925) A.C. 476** where Lord Sumner said at p.488:

"Business is not confined to being busy; in many businesses long in-

tervals of inactivity occur."

(See also **II Ltd v. Comptroller General of Inland Revenue (1950-1985) MTSC 38; (1975) 2 M.L.J. 208**).

The Respondent had also contended that there was no evidence in the form of a Board of Directors' resolution or a tenancy agreement to show that the Company had changed its business activities. However, since letting out buildings was one of the Company's objects and the Company's factory building had in fact been let out from 1978 to 1986 to two business companies, first to TT Sdn Bhd, Nibong Tebal, and subsequently to ML Rubber Trading Sdn Bhd Nibong Tebal, and the rents therefrom had been received and assessed to income tax we are of the view that neither a Board resolution nor tenancy agreement is critical to make a determination on the facts of this case. What matters is the substance of the matter and not whether it is stated in the Minutes of the Appellants (see **The Birmingham & District Cattle By-Products Co. Ltd. v. CIR 12 T.C. 92**). Be that as it may, this objection has only to be stated to be rejected as it is an agreed fact that after the cessation of their business of batik printing the Appellant thereafter let out their factory building.

It is true that the rents received in the years 1978, 1979 and 1980 were classified under sec.4(d) of the Act and the Appellant did not appeal. That, in our opinion, does not preclude the Appellant from raising as objection, as done by them, for subsequent years of assessment. As Greer L.J. said in **IRC v. Sneath (1932) 2 K.B. 362** the tax determined for one year is final for that year and it is not final for any other purpose (see also **Ranaweera v. Ramachandran 45 T.C. 423**). In **M.Y. v. Comptroller General of Inland Revenue (1950-1985) MSTC 127: 1 M.L.J. 84** Abdul Hamid J.(as he then was) said that the fact that the appellant did not object to a previous assessment on a point which he is now contesting is irrelevant. We must add that although the decision in this case was reversed by the Federal Court (see(1972) 2 M.L.J. 110) this point was not disturbed.

In the upshot we held that the rents received from the letting out of the Appellant's factory building for relevant years of assessment constituted income from a business within the meaning of sec.4(a) of the Act and consequently the adjusted losses amounting to RM49,212 brought forward from the Year of Assessment 1978 be deducted against the business income of the Appellant.

We therefore allowed the appeal and discharged the assessments made.

10. The Deciding Order that we made is in the following terms:

"SETELAH MENDENGAR RAYUAN INI dengan kehadiran Encik T, Peguambela dan Peguamcara, bagi pihak Perayu dan Encik Abdul Karim bin Abdul Jalil, Peguam Kanan Persekutuan dibantu oleh Encik W, Penolong Pengarah/Pegawai Penaksir, bagi pihak Responden

ADALAH DIPUTUSKAN BAHAWA sewa yang diterima oleh Perayu daripada penyewaan bangunannya itu adalah merupakan pendapatan daripada perniagaan di bawah seksyen 4(a) Akta Cukai Pendapatan 1967

ADALAH DIPUTUSKAN SELANJUTNYA BAHAWA kerugian yang dibawa ka hadapan dari Tahun Taksiran 1978 berjumlah RM49,212 itu dibenarkan sebagai penolakan daripada pendapatan preniagaan

DAN DENGAN INI ADALAH DIPERINTAHKAN BAHAWA rayuan ini dibenarkan MAKA ADALAH DIPERINTAHKAN SELANJUTNYA BAHAWA Pemberitahu Taksiran Tahun 1983 Borang J(1) C.862248-05 bertarikh 7 Mei 1983, Notis Taksiran Tambahan Tahun Taksiran 1983 Borang JA(1) C.0862248-05 bertarikh 6 Oktkber 1988, Notis Taksiran Tahun Taksiran 1984 Borang J(1) C.0862248-05 bertarikh 6 Oktober 1988, Notis Taksiran Tahun Taksiran 1985 Borang J(1) c. 0862248-05 bertarikh 6 Oktober 1988, Notis Taksiran Tahun Taksiran 1986 Borang c.0862248-05 bertarikh 6 Oktober 1988 dan Notis Taksiran Tambahan Tahun Taksiran 1987 Borang JA(1) C.0862248-05 bertarikh 6 Oktober 1988 itu dipinda sejajar dengan keputusan di atas."

11. The Respondent by a notice dated 6 September 1994 required us to state a case for the opinion of the High Court Pursuant to para. 34 of Sch. 5 of the Income Tax Act 1967, which case we have stated and do sign accordingly.

12. The question for the opinion of the High Court is whether on the facts found by us our decision is correct in law.

Dated 19 August 1994.

Signed
(S. AUGUSTINE PAUL)
Pengerusi,
Pesururhjaya Khas Cukai Pendapatan

Signed
(MOHD GHAZALI B MOHD HANAFIAH)
Pesuruhjaya Khas Cukai Pendapatan

Signed
(KAMARUDDIN B MOHD NOOR)
Pesuruhjaya Khas Cukai Pendapatan

QUOTE

No matter how far you have gone on a wrong road, turn back.

- Turkish proverb-

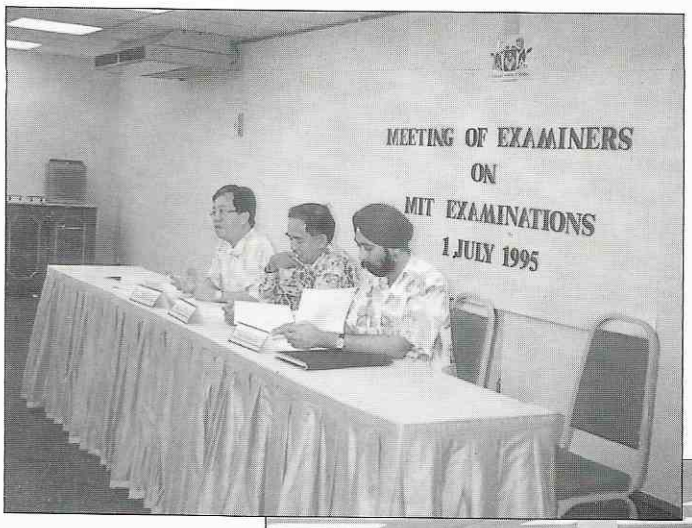
Malaysian Institute Of Taxation

MEETING WITH EXAMINERS

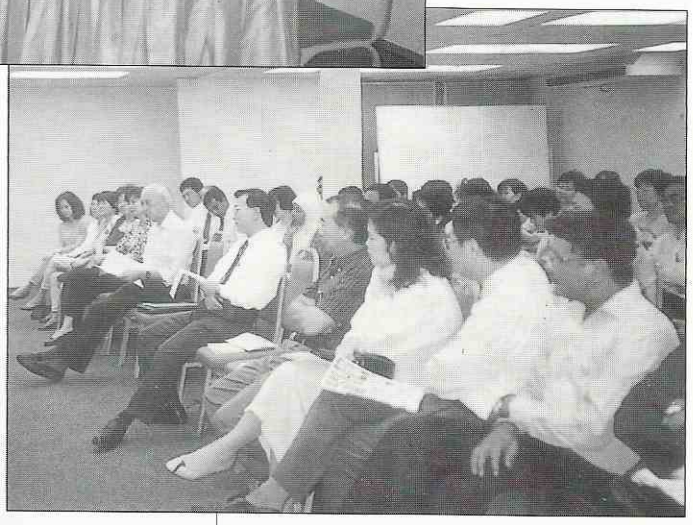
A meeting with all Chief Examiners and Examiners who are involved in the forthcoming MIT Examinations was held on 1 July 1995. Co-Chief Examiners who are Council members were also present.

The meeting was held to brief them on the MIT Examination system and also to provide an avenue for interaction among all Examiners. During the meeting, the President, Ahmad Mustapha Ghazali and Chairmen of the Education & Training and Examinations Committees, Mr Michael Loh and Assoc. Prof. Veerinderjeet Singh respectively thanked the Examiners for their help to ensure that the MIT Examinations would be of high standards.

At the end of the meeting, the Examiners took the opportunity to meet their colleagues who are common Examiners for different examination subjects.



Chairman of Education & Training Committee Mr Michael Loh (left) briefing the examiners. At the centre is President, En Ahmad Mustapha Ghazali and on the right is Assoc. Prof, Veerinderjeet Singh, Chairman of Examination Committee.



A cross-section of Examiners who attended the Meeting of Examiners.

NOTICE TO STUDENTS

Dates to Remember

Closing Date to Register for the 1995 Examination Session:
15 September 1995

Withdrawal from the 1995 Examination Session:
15 November 1995

Examination Dates:
18 to 22 December 1995

Legislation/Accounting Standards

Candidates are expected to be conversant with all accounting standards adopted by the Council of the Malaysian Institute of Accountants (MIA) and all legislation as well as rules and regulations issued by the relevant authorities (e.g. Inland Revenue Department and Customs and Excise Department, etc.) *on or before 31 May 1995.*

STUDENTS' BRIEFING ON MIT EXAMINATIONS

On 22 July 1995, the Institute held a briefing for all Registered Students of the MIT Examinations. The hour long briefing was chaired by Assoc. Prof. Veerinderjeet Singh who is the Examinations Committee Chairman.

Amongst other matters, Assoc. Prof. Veerinderjeet briefed the students on the revision courses being organised by the Institute. He also replied to a student's query that candidates were required to be conversant with all accounting standards adopted by the Malaysian Institute of Accountants' Council and all legislation, rules and regulations issued by the relevant authorities on or before 31 May 1995.

Students listening intently

MIT LAUNCHES RULES & REGULATIONS AND MEMBERSHIP DIRECTORY

On 29 July 1995, the Institute launched its Rules & Regulations (On Professional Conduct & Ethics) and Membership Directory. The launching was held in conjunction with the Institute's Certificate Presentation ceremony. About 40 members were present at this function which was held at the Institute.

The Rules and Regulations, a project undertaken by the Rules and Regulations Committee took two years to complete. During the launching, the President, En Ahmad Mustapha Ghazali in his speech reminded members of their responsibilities and the need for the profession to be governed by a set of rules and regulations which spell out the practitioner's moral duties and obligations towards their clients, employers, members of the public and their professional relationship with other members of the Institute.

The Membership Directory which consists of particulars of 823 members as at 31 December 1994 was also introduced to the members present. The Directory, said the President, would enable members to identify themselves and was also for the public to know our members. The President also informed the members present that the Directory will be reprinted every three years. However to ensure that new members are introduced on a regular basis, a supplement containing data on new members admitted will be produced every 6 months.

To signify the launching of the Rules & Regulations and Membership Directory, Mr Ranjit Singh and Mr Tony Seah, Chairmen of the Rules & Regulations Committee and Membership Committee respectively presented the booklets to the President.

In conjunction with the launching ceremony, a Membership Certificate Presentation ceremony was held. Among those present to receive their certificate of membership was Mr Soon Kwai Choy, President of the Confederation of Asian and Pacific Accountants and Vice President of the Malaysian Institute of Accountants (MIA), Y Bhg Dato' Lau Ban Tin, President of the Malaysian Association of Accounting Technicians and En Ab Razak Ab Lah, past Council Member of MIA.

President, En. Ahmad Mustapha Ghazali delivering his speech whilst, Mr Ranjit Singh, Chairman of Rules and Regulation Committee (left) and Mr Tony Seah Chairman of Membership Committee (right) look on.

CAPA President and MIA Vice-President Mr Soon Kwai Choy accepting his certificate of membership from the President.

Chairman of Membership Committee, Mr Tony Seah presenting a copy of the Membership Directory to the President.

Interviewing Our 1000th Member

The grey clouds did not seem to bother the smiling Dato' Lau Ban Tin as he briskly strolled into the room. Equipped with an organiser in hand, this President of the Malaysian Association of Accounting Technicians (MAAT) sat himself down and the interview proceeded without delay.

Dato' Lau was recently made the 1000th member of the Malaysian Institute of Taxation (MIT). But this developer is no stranger to the world of tax and accounting. Being a member of Malaysian Institute of Accountants (MIA), Dato' Lau always regarded himself to be closely associated with these two institutions. And his admission as an Associate Member of MIT just adds to his involvement with them.

1.000th member ... Y Bhg Dato Lau Ban Tin, MAAT President receiving his certificate from En Ahmad Mustapha Ghazali.

When asked for his views about MIT, Dato' Lau gave an account that the Institute came about at the right time, though it could have been earlier. The level of taxation in Malaysia has advanced into a body of rules suitable for all aspects where foreign industry and investments are concerned. As such, it is indicative of more assurance to have professionals informed on tax advancements through the MIT.

Dato' Lau felt that MIT has an important role to play. Many people have mistakenly perceived that taxation is a means of taking away hard earned income. This, says Dato' Lau, gives MIT an important role to erase the misconception on taxation in Malaysia.

Dato' Lau also shared his thoughts on how MIT could further project itself. The Institute should strive to become a centre for professional studies and research in this region. Such an achievement would give the Institute more recognition within the Asia Pacific region.

Dato' Lau encourages those in the tax practice to come forward and join MIT, not only to upgrade their own capabilities with the latest thinking in tax, but also to avoid working in isolation.

On the whole, we are appreciative of Dato' Lau's expansive views and for his willingness to be interviewed, despite his very busy schedule. Indeed, this man epitomises the phrase, "time is precious"!

The Council of the Malaysia Institue of Taxation wishes all our Hindu members and readers a Happy Deepavali!

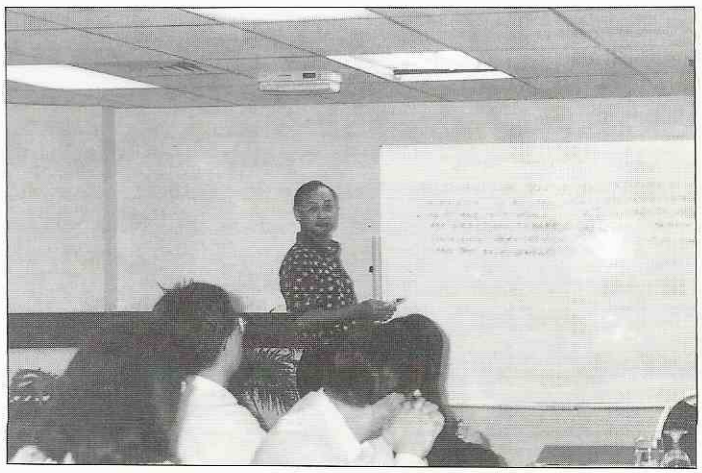
INSTITUTE'S MISSION STATEMENT

On 16 to 17 June 1995, the Council held its first retreat at the Awana Golf & Country Resort, Genting Highlands. The two-day retreat was the result of the Council's intention to conduct a review of the Institute's activities, performance and its image both with the private and public sectors. It was felt that this review is timely as the Institute is in its fourth year of operation.

The retreat focused on the success of the Institute in terms of achieving its objective of being recognised as the national taxation body in the country and authorised to represent the taxation profession in Malaysia with regard to all taxation matters in the country.

To realise the Institute's objective, the Council resolved to be proactive in its efforts to promote the Institute and gain the necessary recognition. The Council has decided on a number of activities it will pursue and over the next few years, the Council through its various committees will put into action its plan. The Council hopes that all members will give their support in achieving the Institute's objectives. To keep this vision in view, the Council after much careful thought drew up a mission statement that is "to enhance the prestige and status of the tax profession in Malaysia; to be the consultative authority on taxation and to provide leadership and direction to enable members to contribute meaningfully to the community and the development of the nation".

Mr Chuah Soon Guan explaining a matter. At the far end is President, En. Ahmad Mustapha Ghazali.



Mr Kang Beng Hoe explaining the Institute's mission statement.

Council members pondering the Institute's future.

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.

VISIT TO DIRECTOR-GENERAL OF ROYAL CUSTOMS AND EXCISE DEPARTMENT

On the 25 July 1995, a delegation of four led by the President, En. Ahmad Mustapha Ghazali; along with En. Atarek Kamil Ibrahim, Mr. Tony Seah Cheoh Wah and Mr. Quah Poh Keat, paid a courtesy visit to the Director-General of Royal Customs and Excise Department, Y. Bhg. Datuk Hj. Mohd. Nor bin Abdul Hamid. Also present were his Deputy Directors-General, Mr. Lim Ewe Chye and Tn. Hj. Ahmad Pabzli bin Mohyiddin.

All who were present heard the Director-General , himself, give a detailed account on the new organisational structure within the Royal Customs and Excise Department. He also explained the existing functions of the different departments.

Following that, En. Ahmad Mustapha Ghazali spoke briefly on the forthcoming MIT Examinations which are purposively held to address the shortage of tax practitioners in Malaysia.

One for the Album ... (left to right) Mr Tony Seah, En Atarek Kamil Ibrahim, President En. Ahmad Mustapha Ghazali, Mr Quah Poh Keat, D-G of Custom & Excise Department - Y Bhg Datuk Hj. Mohd. Nor bin Abdul Hamid, Deputy D-G - Tuan Hj. Ahmad Pabzli bin Mohyiddin and Mr Lim Ewe Chye

En. Ahmad Mustapha also mentioned that the Institute is looking into the possibilities of admitting Customs officers as Associate members. As such, an ad-hoc committee would be set-up to study this matter and would look forward to some assistance from the Customs Department.

During the meeting, both parties explored areas of co-operation between the organisations. In one of the agreed areas of joint co-operation, the Director-General was favourable to the delegation's proposal to have visiting lecturers from the Custom's Training Academy to speak at the Institute's seminars and vice-versa.

ADMISSION TO MEMBERSHIP

The following persons have been admitted as associate members of the Institute as of 25 July 1995.

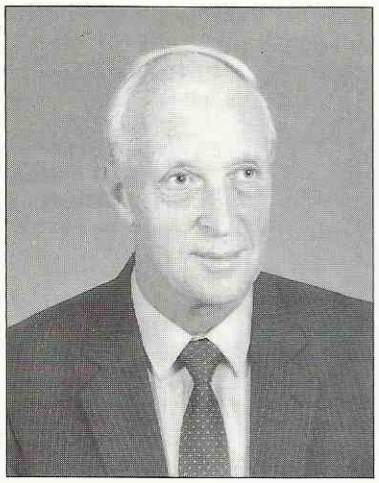
Chong Wai	962	Tan Siew Chu	986
Chang Tian Kwang	963	An Nai	987
Khoo Chuan Keat	964	Kuo Chik Lee, Kenneth	988
Chan Mun Wah	965	Ee Ching Tyin @ Ee Mary	989
Wong Sook Shyan	966	Tee Hwee Leng, Daniel	990
Tiong Pick Sieng @ Hoan Pick Sieng	967	Lau Tung Ee	991
Wong Mok Siw	968	Chia Lean Fung	992
Tan Kwong Hua	969	Aminuddin Bin Haji Yahaya	993
Ho Chee Meow @ Ho Chee Mee	970	Tan Jin Kok	994
Yong Phang Kueng	971	Chew Ah Wah @ Chew Han Chin	995
Tan Geok So Ew	972	Idris Bin Abd. Rahman	996
Ng Teng Hin	973	Foong Kee Leong	997
Chia Ser Chuan	974	Ab. Razak Ab. Lah	998
Ong Ming Yong	975	Goh Joon Hai	999
Yeo Eng Hui	976	Lau Ban Tin, Dato'	1000
David Lee Chee Ming	977	Soon Kwai Choy	1001
Law Piang Woon	978	Teh Ah Hock	1002
Choong Yoke Min	979	Lim Bee Hong	1003
Chen Boon Heow	980	Mustafa Kamal Bin Hj. Maughani	1004
Lim Su Pei	981	Ong Chiow Ngiap	1005
Tan Sam Eng	982	Wong Cheok Mun	1006
Ng Kat Mun	983	Ho Mee Hien	1007
Flora Tok Bee Ting	984	Lim Mui Liang	1008
Wong Teck Keong	985	Chin Chan Leong	1009

MEMBERSHIP STATUS OF MIT AS AT 25 JULY 1995

Honorary Fellows	4
Fellows (Founder Council Members)	14
Associate Members*	1014
	1032

*** Associate Members**

Public Accountants of MIA	686
Registered Accountants of MIA	97
Licensed Accountants of MIA	16
Advanced Course Exam of IRD	90
Advocates & Solicitors	5
Approved Tax Agents	102
Others	19
Deceased	(1)
	1014



Taxation of Cooperatives, Clubs and Associations

Prepared by:
RICHARD THORNTON
Visiting Associate Professor,
Universiti Kebangsaan Malaysia

THE TAXABLE "PERSON"

In imposing the charge to income tax under Section 3, the Income Tax 1967 ("The Act") refers to "persons" . That expression is then defined as including an "unincorporated body of persons". In previous articles, we have considered the liability to income tax of partnerships and trusts and estates, as well as of companies, and we shall now take a look at various other unincorporated bodies. Some of them are recognised and registered by law but some are merely groupings of individuals who come together for various purposes. In some cases, exemption or special treatment is provided for under The Act.

THE PRINCIPLE OF MUTUALITY

Not set out anywhere in The Act is the principle of mutuality, which derives from case law precedents. The fact that an individual cannot make a profit from trading with himself is a well established principle of law. This is extended to cover a group of individuals who have come together for a common purpose such as a club or a mutual insurance association. Provided that none of their dealings are with non-members and that all members who contribute also have the right to any surplus, mutuality is complete and there is no income to be taxed.

There is a difference between carrying on an activity which is intended to benefit all members and happens to make a profit and one which is carried on, even with members, with a view to profit. A co-operative housing society which acquired, subdivided and sold building lots to it's members through a developer was held to be trading in land and assessable to income tax (LPC v. DGIR (1988)(1 MSTC 260;2,073).

Making available facilities to non-members, as is the case with many clubs, means that the results of the club's activities have to be divided and the surplus revenue from services to non-members, less expenses of providing such servicess, taxable whilst any surplus attributable the members' activities is not (Carlisle and Silloth Golf Club v. Smith (1913)(6 TC 48).

The same principles can be applied to the activities of various bodies such as mutual insurance associations, professional societies, trade associations, tontines etc. It is necessary to look carefully at the activities of the particular body in the light of the principles stated above in order to decide whether it operates on the basis of mutuality or not.

THE CHARGE TO TAX - GENERALLY

Except for those bodies which are exempt from tax or charged in a particular way, such as cooperative societies, an unincorporated body is taxed on it's chargeable income at the graduated rates applicable to resident individuals (Part I, Schedule I of The Act) but without the benefit of personal reliefs.

Investment income and the value of occupation of premises for non-business purposes are not covered by the principle of mutuality and is chargeable to tax.

The rules for determination of income and basis periods are the same as those for other persons.

BODIES EXEMPTED FROM TAX

In addition to bodies which have been exempted from tax by the Minster of Finance under Statutory Order, the income of certain bodies is specifically exempted under Schedule 6 of The Act:-

EXAMPLE 1

For the year 1994, the Swanky Golf Club had the following result:

	RM
Entrance fees and subscriptions	4,000,000
Booking and green fees	120,000
Bar and restaurant sales	1,500,000
Loan interest	70,000
	5,690,000
Expenses incurred	3,950,000
Members' surplus	1,740,000

Fees and sales to non-members were RM275,000 and it is determined that the proportion of costs spent to provide those servces was RM225,000. The club occupied one of it's buildings, with an annual value of RM25,000, for non-business purposes and the expenses related to that building amounted to RM7,500.

The Club's liability to income tax for the year of assessment 1995 is:-

	RM
Business income RM275,000 minus RM225,000	50,000
Interest income	70,000
Occupation of premises RM25,000 minus RM7,500	17,500
	137,500
Tax on RM100,000	18,575.00
on RM 37,500 at 31%	11,625.00
	30,200.00

Paragraph 12

Income of any co-operative society for five years from the date of registration and thereafter for any year in which the members' funds at the beginning of the basis year for the year of assessment is less than RM500,000.

Members' funds means the aggregate of:-

Paid up capital in respect of shares
Statutory reserve fund
Reserves
Balance of share premium account
Balance of profit and loss account

Members' funds does not include:-

Any capital reserve created by revaluation of fixed assets or any shares or share premium arising from the issue of bonus shares out of such reserve.

Any provision for depreciation, renewals or replacements and diminution in value of assets.

The exemption for co-operative societies has undergone some changes over the years and the changes have produced some interesting decisions by the Special Commissioners (see the June 1995 issue of Tax Nasional at page 5).

For the purposes of income tax, "co-operative society" means one which is registered under any written law relating to the registration of co-operative societies in Malaysia.

Paragraph 13

Income of:

(1) a charitable institution, trust body or other body established in Malaysia for charitable purposes only, which is approved by the Director General of Inland Revenue, and applies all of it's income, and in each year not less than 70% (or such other percentage as may be approved by the Director General of Inland Revenue), solely for charitable purposes.

(2) a building fund approved under Section 44(6) of The Act.

(3) an institution or organisation established in Malaysia exclusively for the purposes of religious worship or the advancement of religion, and which is not operated primarily for profit.

In the English House of Lords case of Special Commissioners v. Pemsel (1891) (3 TC 53), the meaning of "charity" was said to comprise the relief of poverty, the advancement of education, the advancement of religion and purposes beneficial to the community.

Business income is not exempt but, to cover activities such as the running of a religious bookshop, the exemption extends to any business income if the business is done in carrying out the primary purpose of the body and the work is carried out mainly by persons for whose benefit the body was established.

Paragraph 17

Income of a trade union registered under any written law relating to trade unions. The exemption does not apply to business income.

Paragraph 26

Income of:

(1) any national amateur sports association certified by the President and Secretary of the Olympics Council of Malaysia to be affiliated to that Council.

(2) any State amateur sports organisation certified by the President (or corresponding officer) and Secretary of an organisation to which (1) applies to be affiliated to that organisation.

In the case of the bodies mentioned in paragraphs 13, 17 and 26, the exemption does not apply to dividend income received by them. Therefore, such bodies will be unable to obtain a repayment of the income tax deemed to have been deducted at source from Malaysian dividends.

EXAMPLE 2

Koperasi AZ, which has been registered since 1987, had the following results for 1993 and 1994:-

	1993 RM	1994 RM
Net trading profit	100,000	160,000
Malaysian dividends - gross	3,000	5,000
Interest on loans	15,000	23,000
	118,000	188,000
Administration and management costs	38,000	48,000
Audited net profit	80,000	140,000
Profit and loss account balance brought forward	90,000	110,000
	170,000	250,000
Transfer to statutory reserve	60,000	75,000
	110,000	175,000
In respect of the above:-		
tax deducted from dividends was	960	1,500
disallowable costs are	4,000	6,000

On the 1st January each year the capital and reserves position was:-

Paid up capital	400,000	600,000
Statutory reserve fund	-	60,000
Asset revaluation reserve	70,000	70,000
Profit and loss account	90,000	110,000
	560,000	840,000

For the year of assessment 1994, Koperasi AZ has been registered for more than 5 years and cannot be exempted from income tax on that ground. Nevertheless, because it's members funds at 1st January 1993, as defined, was less then RM500,000 (RM560,000 as above less the asset revaluation reserve of RM70,000), Koperasi AZ will be exempted for that year. A repayment of the tax deducted from dividends, RM960, can be claimed.

For the year of assessment 1995 no exemption is available because members' funds at 1st January 1994 exceeded the limit.

EXAMPLE 3

Facts as in example 2.

The tax position of Koperasi AZ for the year of assessment 1995 will be as follows:-

	RM	RM
Audited net profit		140,000
Add disallowable costs		6,000
		146,000
Less: dividends	5,000	
interest	23,000	28,000
Business income		118,000
Dividends		5,000
Interest		23,000
Total income		146,000
Secton 65A deductions:-		
transfer to statutory reserve fund RM75,000 but limited to 25% of audited net profit	35,000	
8% of members' funds, as defined, at 1st January 1994. (RM840,000 minus RM70,000)	61,600	96,600
Chargeable income		49,400
Tax payable:		
onRM40,000		1,900
on RM9,400 at 12%		1,128
		3,028
less set off for tax on dividend		1,500
net amount payable		1,528

THE CHARGE TO TAX - CO-OPERATIVE SOCIETIES

Subject to any exemption (see above), the same rules for determination of income and basis periods apply to co-operative societies as to other persons, but there are some modifications. Co-operative societies are allowed to make the following special deductions from total income in arriving at their chargeable income for a year of assessment:-

(1) any sum transferred to (i) a statutory reserve fund, (ii) an educational institution or co-operative organisation established for the furtherance of co-operative principles or (ii) a Co-operative Educational Trust Fund as provided under written law relating to co-operative societies in Malaysia.

but limited to 25% of the audited net profits for the basis period for the year of assessment.

(2) from year of assessment 1995, 8% of the members' funds (as defined in paragraph 12, Schedule 6 - see above) at the beginning of the basis period (previously 6%).

In addition, co-operative societies have their own scale of graduated rates which apply to chargeable income (Part IV, Schedule I of The Act). The rates were reduced from year of assessment 1995. They apply to chargeable incomes up to RM500,000 and range from 1% on the first RM10,000 to 30% on the last RM250,000. Any excess over RM500,000 is charged at 32%.

A co-operative society is not required to deduct tax on paying dividends to members. So far as the member himself is concerned, he is exempted under paragraph 12A from income tax on any dividend paid, credited or distributed by the society, regardless of whether the society is taxable on it's income or not.

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Malaysian Institute Of Taxation

HOW TO BECOME A MEMBER OF THE MALAYSIAN INSTITUTE OF TAXATION

Benefits and Privileges of Membership

The Principal benefits to be derived from membership are:

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

Qualification Required For Membership

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

Associate Membership

1. Any person who has passed the Advanced Course examination conducted by the Department of Inland Revenue and who has not less than five (5) years practical experience in practice or employment relating to taxation matters approved by the Council.
2. Any person whether in practice or in employment who is an advocate or solicitor of the High Court of Malaya, Sabah and Sarawak and who has had not less than five (5) years practical experience in practice or employment relating to taxation matters approved by the Council.
3. Any Registered Student who has passed the examinations prescribed (unless the Council shall have granted exemptions from such examinations or parts thereof) and who has had not less than five (5) years practical experience in practice or employment relating to taxation matters approved by the Council.
4. Any person who is registered with MIA as a Registered Accountant and who has had not less than two (2) years practical experience in practice or employment relating to taxation matters approved by the Council after passing the examination specified in Part 1 of the First Schedule or the Final Examination of The Association Of Accountants specified in Part II of the First Schedule to the Accountants Act, 1967.
5. Any person who is registered with MIA as a Public Accountant.
6. Any person who is registered with MIA as a Licensed Accountant and who has had not less than five (5) years practical experience in practice relating to taxation matters approved by the Council after admission as a licensed accountant of the MIA under the Accountants Act, 1967.
7. Any person who is authorised under sub-section (2)/(6) of Section 8 of the Companies Act, 1965 to act as an approved company auditor without limitations or conditions.
8. Any person who is granted limited or conditional approval under Subsection (6) of Section 8 of the Companies Act, 1965 to act as an approved company auditor.
9. Any person who is an approved Tax Agent under Section 153 of the Income Tax Act, 1967.

Fellow Membership

1. A Fellow may be elected by the Council provided the applicant has been an Associate Member for not less than five (5) years and in the opinion of the Council he is a fit and proper person to be admitted as a Fellow.
2. Notwithstanding, Article 8(1) of the Articles of Association, the First Council Members shall be deemed to be Fellows of the Institute.

Application of Membership

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

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

		Fellow	Associate
(a)	Admission Fee:	RM300	RM200
(b)	Annual Subscription:	RM100	RM75

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

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

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

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