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1ST AOTCA CONFERENCE TO BE HOSTED BY MIT

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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.

5th AOTCA GENERAL COUNCIL MEETING & TRAVEL SEMINAR IN MANILA

The 5th General Council Meeting of the Asia-Oceania Tax Consultants' Association (AOTCA), hosted by the Tax Management Association of the Philippines (TMAP) was held at the Shangrila's EDSA Plaza Hotel which is located at Mandaluyong City of Metro Manila, Philippines on 7 November 1997. Among the matters discussed during the Council Meeting were the publication of the next issues of the 'AOTCA JOURNAL' as well as the date and venue of the 3rd regular general meeting and the 6th General Council Meeting which are both expected to be held next year in Kuala Lumpur on 10 November 1998 in conjunction with the 1st International Convention of the AOTCA.

The Council also agreed that the AOTCA's International Convention will be held for 3 days, once in every two years on the occasion of its regular general meeting. They further confirmed MIT as the host to the 1st International Convention of the AOTCA and Mr Kang Beng Hoe, the Chairman of the MIT Conference Organising Committee as the Convention Chairman.

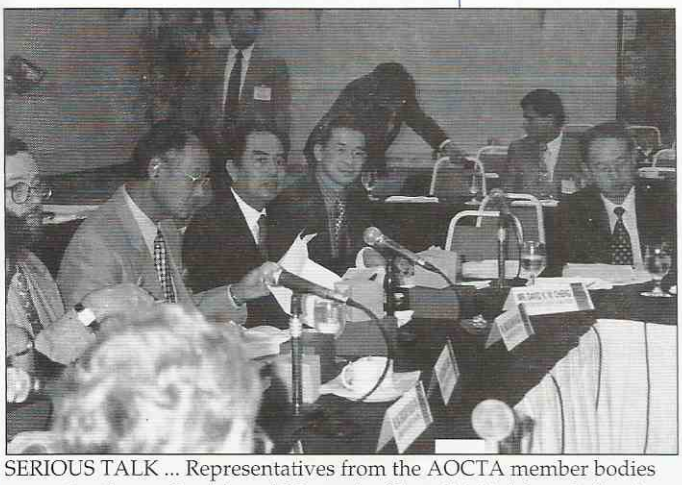
A speaker from Japan Federation of CPTAs' addressing the delegates during one of the seminars

Mr Kang Beng Hoe and Mr Chuah Soon Guan, the Honorary Secretary to the MIT, later briefed the Council on the progress of the preparation for the 1998 AOTCA Convention. The Mandarin Oriental Hotel in Kuala Lumpur has been confirmed as the venue of the Convention which will be held from 11 to 13 November 1998. The theme selected for the Convention i.e. "Tax & Investment Issues in the New Millennium" was found to be very appropriate for the Convention. Some of the topics proposed were:

- Malaysia: Doing Business in the Multimedia Super Corridor
- ASEAN as a dynamic common market - post AFTA
- The shift towards Consumption Taxes
- Taxation of Electronic Commerce
- Double Taxation Treaties between Industrialised and Developing Countries

The member bodies of the AOTCA, which is the first international organisation composed of tax-related organisations in the Asia-Oceania region, are as follows:

- Taxation Institute of Australia
- All Pakistan Tax Bar Association
- Australian Society of Certified Practising Accountants
- Hong Kong Society of Accountants
- Institute of Chartered Accountants in Australia
- Japan Federation of Certified Public Tax Accountants' Associations
- Japan Tax Research Institute
- Korean Association of Certified Public Tax Accountants



SERIOUS TALK ... Representatives from the AOCTA member bodies pays attention as En. Ahmad Mustapha Ghazali (third from left) raises a point. Listening in is Mr Kang Beng Hoe (second from left) who is the Chairman of the MIT Conference Organising Committee.

WITH THE HOST ... (from left) Mr. David Russell, Mr Kang Beng Hoe, Ms Grace Tan (from TMAP), En Ahmad Mustapha Ghazali and Mr Chuah Soon Guan

GOODBYE MANILA ... KUALA LUMPUR, HERE WE COME ... Representatives from the member bodies of the AOTCA posing in a group after the meeting.

- Malaysian Institute of Taxation
- Tax Accountancy Association of Republic of China
- Tax Management Association of the Philippines
- Taxation Institute of Hong Kong

The Institute is honoured to have its President, En Ahmad Mustapha Ghazali, holding the position of Vice President of the said Association.

A day before the Council Meeting, a General Council Workshop was held to reflect on the Association's first five years and to look into overseas linkages and relationships with other tax bodies as well as on the future expansion of the Association.

In conjunction with this General Council Meeting, the MIT with the assistance of Yangtze Cruise & Tour Sdn Bhd arranged an attractive tour package to Manila, Philippines from November 5 to 9, 1997. Members took this opportunity to enjoy the tour delights of Manila as well as to attend some seminars on taxation and investments.

The delegation of 12 members which included some of the MIT Council Members stayed in Shangrila's EDSA Plaza Hotel and Manila Galleria Suites. The location of these hotels were truly a shoppers paradise as they are situated in one of the largest shopping districts in Metro Manila, with three of the biggest malls in the Philippines: SM Mega Mall, Shangrila Plaza and Robinson's Galleria, all of which are walking distances from each other and the hotels.

Seminars on "Taxation of Foreign Persons in the Philippines" and "Investment in the Asia-Oceania Region" was also held to update delegates on the taxation system in Philippines and the opportunities for investment in the Asia-Oceania region. Among the highlights of the seminars was a presentation of paper on "Investing in Malaysia" by Mr Kang Beng Hoe.

Delegates enjoyed a full day excursion to Tagaytay City, a scenic resort town outside of Metro Manila and home to the smallest volcano in the world which rises from Taal Lake. Apart from this, a half day city tour which includes a tour of the Makati business district and landmarks of the City of Manila such as the Coconut Palace, Rizal Park, Fort Santiago and many other interesting places also kept the delegates captivated with their charms and beautiful scenery.

The scenic drive around Laguna de Bay, the source of inspiration of many a folk and fine artists during a whole day tour of lakeside towns of the provinces of Rizal and Laguna which are adjacent to Metro Manila would still be lingering in the minds of delegates who were on this tour.

The Institute would like to take this opportunity to extend their sincere gratitude to the following persons who have attended the travel seminar which was especially arranged for the members and their spouses:

En. Hamzah HM Saman
Pn Teh Halimah Abdullah
Mr Tang Chin Fook
Ms Faun Kam Pheng
Mr Stanley Loy Kiat Seng
Mr Wan Heng Choon
Ms Soo Chau Sen
Ms Wong Lai Kuen

INVESTING IN AUSTRALIA*

Richard J Vann
Professor of Law, University of Sydney
Consultant, Greenwoods & Freehills, Sydney

Two main bodies of law are relevant to investing in Australia - laws dealing with foreign investment and taxation. In this paper I summarise briefly the main features of the investment laws applicable in Australia.[1] Attached is a summary of Australian tax laws as they affect foreign investment in Australia which has been mainly prepared by my colleague, Robert Allerdice, with assistance from me for the tax consulting firm Greenwoods & Freehills of Sydney.

DOMESTIC LAWS REGULATING INVESTMENT

Governing legislation and the Foreign Investment Review Board

The Australian government's foreign investment policy is embodied in the Foreign Acquisitions and Takeovers Act 1975 and certain other requirements set out in Ministerial statements. The Treasurer is responsible for the administration of the policy and is assisted in this by an advisory body called the Foreign Investment Review Board ("the FIRB").

FIRB must be notified of certain investments by foreign interests

In terms of the legislation, if a foreign interest wishes to invest in certain categories of Australian assets the FIRB must be notified of the proposal. The function of the FIRB is to examine the proposal and to advise the Treasurer as to whether it is contrary to the national interest. If the Treasurer is of the opinion that the proposal is contrary to the national interest he will prohibit the investment.

What is a "foreign interest"?

A "foreign interest" is defined as -

- a natural person not ordinarily resident in Australia;
- any corporation, business or trust in which there is a substantial foreign interest, regardless of whether the corporation, business or trust is foreign controlled.

A natural person who is a citizen of a foreign country will not be considered to be ordinarily resident in Australia unless he/she has actually been in Australia for 200 days in the previous 12 months and there is no legal limitation on him/her remaining in Australia indefinitely.

A substantial foreign interest in a corporation, business or trust is taken to be a holding of 15% or more by a single non-resident person or foreign corporation (either alone or together with associates), or holdings of 40% or more in aggregate by two or more nonresident persons or foreign corporations (and any associates). Indirectly held interests will be taken into account.

What types of investments must be notified?

The proposals of which notice must be given to the FIRB are, very briefly, as follows:

1. Proposals falling with the scope of the Foreign Acquisitions and Takeovers Act, being -
   a) acquisitions of interests in urban real estate regardless of value;
   b) acquisitions of shareholdings of 15% or more in Australian companies that have total assets valued at more than $5 million ($3 million if more than 50% of the assets of the company are in the form of rural land);
   c) takeovers of Australian companies or businesses that have total assets of more than $5 million ($3 million if more than 50% of the assets are in the form of rural land) by means other than the acquisition of shares, such as -
      - the purchase of assets;
      - agreements relating to board representation;
      - arrangements for participating in the profits of a business;
   d) takeovers of offshore companies that have Australian subsidiaries or assets valued at $20 million or more, or where the value of the Australian subsidiaries or assets is more than half of the value of the global assets of the target company;
   e) the acquisition of shares or units in a company or trust whose assets consist mainly of urban property, even if the assets are worth less than $5 million.
2. Investment proposals not coming under the Foreign Acquisitions and Takeovers Act but falling within the following categories:
   a) any proposals in the media sector, regardless of size;
   b) proposals to establish new businesses in other sectors of the economy where the total

* My thanks to Charleen Hefer and Celeste Black for research assistance and drafting, and to the Australian Research Council for financial support.

[1] The standard text containing the relevant source documents is R Hamilton, Foreign Investment Regulation in Australia (Sydney, Prospect 1997, 2nd ed looseleaf).

amount of the investment is $10 million or more. A new business includes:

i) a new business by a foreign interest not already operating in Australia;

ii) a new project in tourism, mining, raw material processing, agriculture, forestry or fishing, even if the foreign interest is already operating a similar project;

iii) the diversification by a foreign interest already operating in Australia into an activity not previously undertaken in Australia;

c) direct investments by foreign governments or their agencies, regardless of size.

Examination and approval by the FIRB

Prior to 1992, the FIRB examined most proposals. However, on 26 February 1992, the Government announced a liberalisation of foreign investment policy in the following sectors:

- rural properties
- agriculture
- forestry
- fishing
- resource processing
- oil and gas
- mining (excluding uranium)
- manufacturing
- non-bank financial intermediaries
- insurance
- stockbroking
- tourism (hotels and resorts)
- other services (excluding urban real estate, banking, civil aviation and the media).

Proposals relating to these sectors must still be submitted to the FIRB but will normally not be examined or required to meet the national interest test if they involve -

- the acquisition of 15% or more of a company or business valued below $50 million;
- a new project or business with a total investment of below $50 million;
- the takeover of an offshore company with Australian subsidiaries or assets valued below $50 million and not exceeding half the global asset values.

Where the value of the target assets or the investment exceeds such $50 million limits the proposal will be examined by the FIRB and will be approved unless it is found to be contrary to the national interest.

Urban real estate

All proposed acquisitions of urban real estate by foreign interests must be individually submitted for examination unless they fall into a class of acquisition that is exempt from examination. By "urban real estate" is meant any Australian real property other than land that is integral to a farming business.

The exemptions relate to the following acquisitions of real estate:-

- acquisitions by charities, life assurance companies and pension funds for the benefit of Australians;
- acquisitions by insurance companies operating in Australia;
- acquisitions by foreign governments for use as official missions or staff residences;
- acquisitions from property developers "off the plan", or while under construction or while never having been lived in before, provided the developer has applied in advance to the FIRB and the application has been approved;
- the acquisition of industrial or commercial property wholly and directly incidental to the conduct of the present or proposed business activities of the foreign interest;
- the acquisition of an interest in a time share scheme with an entitlement of less than four weeks per year;
- the acquisition of limited quantities of Australian units trusts and listed shares in certain property-owning or property development trusts or companies;
- acquisitions by Australian citizens abroad and by intending migrants with rights of permanent residence;
- acquisitions of non-residential commercial real estate at less than $5 million;
- acquisitions of residential real estate in a resort that the govern-

ment has designated an Integrated Tourism Resort.

State laws regulating investment

There are various laws at the state (as opposed to federal) level that deal with particular kinds of investment such as mining. Again ownership of land is a sensitive issue with Queensland having specific legislation requiring registration of foreign ownership of land (Foreign Ownership of Land Register Act 1988). Something similar was proposed in Western Australia but has not been proceeded with by the new government there.

Summary

Over recent years Australia's controls over foreign investment have been considerably relaxed and it is likely that, partly under the influence of developments referred to below, this liberalisation will continue. To give some idea of the minimal government interference in foreign investment proposals the following statistics appear in the FIRB annual report for 1995-96. During the 1995-96 financial year, FIRB considered 4090 proposals. Of these 4005 were approved and 85 were rejected. Those rejected related to the real estate sector.[2]

The policy on government investment can be summarised very simply as follows:

1. if a foreign interest wishes to invest in Australia in any of the categories of investment listed in the paragraph on **What types of investments must be notified?** above, it must notify the FIRB of the proposal;

2. in most cases, the proposal will not be examined and will not be required to meet the national interest test;

3. however, the proposal will be examined and will be required to meet the national interest test if-

   a) it relates to one of the sectors listed in paragraph under **Examination and approval by the FIRB** above, and the value of the target assets or the proposed investment is more than $50 million;

   b) it relates to banking, civil aviation or uranium mining, and the value of the target assets or the proposed investment exceed the limits prescribed in terms of the Foreign Acquisitions and Takeovers Act;

   c) it relates to the media, regardless of the size of the investment;

   d) it relates to the acquisition of urban real estate, regardless of the size of the investment, unless the acquisition falls into one of the exempted categories listed in the paragraph on **Urban real estate** above.

INTERNATIONAL INVESTMENT INSTRUMENTS

Australia is a party to a number of international instruments affecting investment laws, including bilateral treaties and existing and emerging multilateral initiatives.

Bilateral Investment Agreements

A large number of bilateral agreements exist to promote and protect cross-border investments. Australia alone has twelve agreements for the reciprocal promotion and protection of investments.[3] These agreements generally follow a model and apply to "investments" which is generally defined in article 1 to include every kind of asset owned or controlled by nationals of a contracting party and includes tangible and intangible property, shares, bonds, debentures and any other form of participation in a company, loans, intellectual and industrial property rights, business concessions and activities associated with investments such as the organisation and operation of business facilities. The term "national" is defined to mean a natural person who is a citizen or permanent resident or a company which is organised under the laws of a contracting state or organised under the laws of a third state and controlled by a company organised in a contracting state or by a natural person who is a national of a contracting state. If a company which otherwise qualifies as a national of a contracting party is owned or controlled (which is defined to include a substantial interest) by a citizen or company of a third country, the contracting parties may decide jointly not to extend the rights and benefits of the agreement to that company.

The agreements contain, inter alia, a general most favoured nation ("MFN") obligation with regard to investments, restrictions on expropriation and nationalisation, a MFN obligation applicable to compensation for losses and other investor protection measures, and dispute resolution processes. As an example of the typical MFN obligation in these agreements, article 4 of the 1994 investment agreement between Australia and Laos[4] states as follows:

[2] For more information, see the FIRB homepage at http ://www.treasury.gov .au.

[3] Agreements for the Reciprocal Promotion and Protection of Investments exist between Australia and Argentina (signed 23.8.95 but not yet in force), the Czech Republic, Hong Kong, Hungary, Indonesia, Laos, Papua New Guinea Peru, the Philippines, Poland, Romania and Vietnam.

A Contracting Party shall at all times treat investments in its own territory on a basis no less favourable than that accorded to investments of nationals of any third country, provided that a Contracting Party shall not be obliged to extend to investments any treatment preference or privilege resulting from:

(a) any customs union, economic union, free trade area or regional economic integration agreement to which the Contracting Party belongs; or

(b) the provisions of a double taxation agreement with a third country.

These and other provisions of international investment instruments raise interesting questions in relation to taxation. This particular MFN obligation would appear to apply to the direct taxation of investment income and realisation of capital gains but carves-out preferences under double tax treaties. Expropriations must not be discriminatory (article 7(2)) and compensation for losses in the event of war must meet a MFN standard (article 8). This treatment may be contrasted with the model used by the United Kingdom which, though extending both MFN and national treatment obligations to investments (article 3), carves out the benefit of any treatment preference or privilege resulting from any international agreement or arrangement relating wholly or mainly to taxation as well as any domestic legislation relating wholly or mainly to taxation (article 7)[5]. The United States model bilateral investment treaty also carves-out taxation except in relation to certain expropriation matters (article XIII).

In the area of dispute resolution, the agreements provide for mechanisms for state-to-state and state-to-national disputes (articles 11 and 12, respectively). Contracting parties are to first attempt to resolve a dispute connected with the agreement by consultation and if that is not successful, the matter may be submitted to an arbitral tribunal established under the agreement. In disputes between a state and a national, the first recourse is to consultation and, if that fails, the matter may be pursued through one of the following: competent authorities of the relevant state, the International Centre for the Settlement of Investment Disputes (if both states are then party to the 1965 Convention on the Settlement of Investment Disputes between States and Nationals); or an arbitral tribunal established under the agreement.

OECD Instruments

Australia is a member of the OECD and accordingly has associated itself with the 1976 OECD declaration on international investment and multinational enterprises. Much bigger developments are in train, however.

The Multilateral Agreement on Investment (MAI) is currently under negotiation in the OECD and will be open to all members on its conclusion.[6] It is also Proposed (by the EU at least) that a joint extension of the agreement be developed between the OECD and the WTO for adoption by non-OECD members of the latter organisation.

The MAI builds on previous OEC work and on the framework of nu merous bilateral investments agree ments, regional economic integratio organisations (such as the Europea Union (EU) and the North America Free Trade Area (NAFTA)). It focuse on investment liberalisation, investo protection and dispute resolution. I the area of liberalisation, broad MF and national treatment obligations ar proposed. With regard to investo protection, standards with respect t expropriation as well as the transfe and repatriation of funds are being formulated. In the field of dispute reso lution, both state-to-state and inves tor-state arbitration are proposed. In defining the scope of the agreement the term "investment" is likely to be defined broadly and include portfolio investments.

One issue which has arisen in negotiations and has yet to be resolved is the extent to which, if at all, the MAI should apply to taxation matters.

[4] Agreement between Australia and the Lao People's Democratic Republic on the Reciprocal Promotion and Protection of Investments, 1994 ATS No. 9.

[5] See, for example, the Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of Kazakhstan for the Promotion and Protection of Investments, 1995, UKTS (1996) No. 30.

[6] For a recent discussion of the status and issues arising from the MAI see R. Couzin, Taxation and the Multilateral Agreement on Investment, Tax Notes International, June 24, 1996, p. 2049.

NOTE:
This paper was presented at the Asia-Oceania Tax Consultants (AOTCA) seminar held in Philippines on 7 November 1997.

Tax Considerations for Investment in China

Thomas Lee
The Taxation Institute of Hong Kong

Tax Administration
The formulation of tax policy is primarily the responsibility of the Ministry of Finance while the State Administration of Taxation is in charge of the administration of the tax laws. Local tax authorities set up in provinces, cities, counties, towns and villages are responsible for the processing of tax returns and collection of taxes.

Tax Laws
In China, there is no codified tax law on all the taxes or even on income taxes administered by the State Administration of Taxation. Different laws promulgated at different times impose tax on different taxpayers and activities. The administration of these tax laws are supplemented by implementation regulations, rulings and interpretations issued by the Ministry of Finance or the State Administration of Taxation.

PRINCIPAL TAXES IN CHINA

Individual Income Tax (IIT)
IIT is imposed on remunerations and fringe benefits from employment and business profits and other incidental income of an individual who is either a person residing in China or deriving income from a source within China.

There are different tax rules depending on the period of stay of an individual in China. An individual who is a temporary visitor in China who spends less than 90 days in China in a calendar year, or 183 days if a tax treaty applies, is only chargeable to IIT in respect of his employment income derived from within China which is paid by an overseas employer and which is not borne by an establishment or company in China, on the portion of his income which is derived during his actual working period within China. Time apportionment method usually applies to arrive at the taxable IIT income.

Enterprise Income Tax for Foreign Enterprises
Domestic Chinese-owned enterprises are subject to a tax regime different from that applicable to foreign enterprises doing business in China either through an establishment, a wholly foreign-owned investment enterprises or a Sino-foreign joint venture.

Foreign investment enterprises formed in China and foreign enterprises with establishments in China or which derive income from China are subject to corporate income tax under the Foreign Enterprise Income Tax Law and the relevant implementation rules. The standard foreign enterprise income tax rate is 33%. The Chinese Government, to attract foreign investment into China has introduced certain tax incentives for foreign enterprises.

All foreign enterprises, engaged in production, are technologically advanced, export oriented or located in Special Economic Zones or Hi-tech Industry Development Zones are offered special rate of tax at 15% and entitled to a tax holiday of exemption from all enterprises income tax for the first 2 years and half rate of tax i.e. 7.5% for the 3rd and 5th years.

Value Added Tax ("VAT")
It is an indirect tax assessed on the sellers and importers of goods. In principle, the VAT burden is passed on to the ultimate consumers, and the seller merely acts as a collection agent for the tax authorities. Providers of services are normally not subject to VAT, with the exception of those engaged in processing and repair services. Taxable goods include all tangible and moveable properties, and real properties are excluded.

VAT payable to the tax authorities are computed in the following manner:

VAT
payable = Output VAT - Input VAT.

The basic VAT rate is 17% with a reduced rate of 13% for basic necessities and agricultural products. VAT rate for export goods is 0%.

Business Tax
Business Tax is imposed on various services and on income not derived from production at rate of 3% or 5%, exception for entertainment services, which are subject to tax between 5% and 20%.

Consumption Tax
Consumption tax is a turnover tax levied on certain luxury items, including cigarettes, gasoline, jewelry, cosmetics and motor vehicles. For imported goods, consumption tax is charged in addition to customs duty, but before the imposition of VAT. The tax rates range from 3% to 45%.

Other Taxes
Real property capital gains tax, stamp duty, real estate and land use tax.

NOTE:
This paper was presented at the AOTCA seminar held in Philippines on 7 November 1997.

Environment of Foreign Investment to Japan

Shoji UEMATSU
Japan Federation of CPTAs Associations

Current status of foreign direct investment to Japan

In 1996, foreign direct investment to Japan marked 770.7 billion yen which was more than double of previous year. This explosive increase improved the ratio of investment inflow and outflow to 1:7.

However, according to the White Paper on International Trade issued by the Ministry of International Trade and Industry (MITI) in 1997, Japan's cumulative foreign direct investment inflows were only 0.1% of those of the United States and 0.2% of those of the United Kingdom and China. In those countries, the outflows are equal to or 2 times larger than the level of inflows, but 13 times for Japan. In case of non-manufacturing industries, outflows were more than 20 times in 1994.

Thus, foreign direct investment to Japan shows the features (1) the absolute amount is obviously small despite of its scale of economy, (2) the gap between inflow and outflow is large in terms of amount (3) the level of investment in the tertiary industry such as services is quite low.

Effect of foreign direct investment

Foreign direct investment contributes to the increase of employment opportunities as well as the people's income. It also brings the following benefits.

Firstly, foreign direct investment brings the economic resources accumulated in the foreign companies. These economic resources include technology, marketing, business know-how. Moreover, some spillover effect could be expected if foreign companies establish sales bases or research centers in Japan.

Secondly, the participation of foreign companies to the domestic market is expected to accelerate the competition which could be a significant stimulant for activation of industries and reformation of economic structure. For example, in early 90s, the foreign companies appeared to the domestic market of personal computers and ignited fierce competition. This competition brought price cuts by Japanese manufacturers and gave tremendous impact to the prices of personal computers in 1996.

Thirdly, the increase in the number of foreign capital-affiliated companies helps to expand the Japan's imports. Because in many cases, these companies act more as sales bases than as production bases, foreign companies have high import ratios. The survey conducted by MITI shows that these companies accounted for 4.01 trillion yen in imports, or 14% of Japan's total imports in 1994. Imports make up 37% of all procurement by foreign-affiliated companies in total.

Incentives

Recognizing the contribution of foreign direct investment to the economy and to balancing Japan's trade, the Japanese government adopted policies to improve the investment environment and encourage investment inflows. The Economic Planning Agency announced to make it a priority attract foreign capital-affiliated companies to local regions and to encourage more foreign-led mergers and acquisitions (M&A).

Although foreign investment in the form of M&A is still rare, it is on the increase, and in 1996 there were some major M&As. Good example is the increase in the equity stake Ford Motor Co. of the United States holds in Mazda Motor Corp. Before this, the buy-up of a major Japanese company by a foreign company caused a sensation, but the increase in Ford's stake and its takeover of Mazda's management were greeted calmly. This change of attitude suggests a wider acceptance of foreign-led M&As in Japan.

Foreign direct investment in Japan's retail sector is relatively low. Nevertheless, revision of Large-Scale Retail Store Law have encouraged the participation by the foreign capitals. A striking recent trend is the increase in the number of foreign capital-affiliated distributors planning widespread store networks in Japan by the use of innovative systems.

At the same time, more and more foreign capital-affiliated companies are building retail chains on their own. The pioneer in this area was Toys-R-Us Japan, which has left a indelible mark in Japan's distributing system.

Obstacles and Benefits

As mentioned so far, the climate of foreign investments inflow to Japan is showing improvements, however the level still stays low comparing with other countries.

According to the recent MITI's survey in March 1997, foreign companies which are interested in Japanese market pointed out the obstacles which hamper the investment to Japan. They were (1) language, (2) lack of information, (3) different culture and business practices, (4) competitiveness, (5) high costs, (G) regulations/licensing, and (7) shortage of manpower.

Another survey conducted by Japan External Trade Organization (JETRO) reported that the foreign capital-af-

iliated companies in Japan felt the llowing constraints: (1) high operatng costs such as wages, real-estate, istribution, taxes, (2) Japanese busiess practices including transactions mong affiliated companies, complex istribution channels, personal conections, (3) high level of consumers emands in terms of quality and price, (4) difficulty in securing manpower, (5) unstable exchange rate, (6) opaque administrative procedures, (7) lack of incentives, and (8) shortage of information services.

On the contrary, the result of poll by the Tokyo Metropolitan government in 1994 pointed the benefits such as (1) size of market and its growth, (2) global importance of Japanese market, (3) sales base in Asia, (4) high level of technology, (5) high quality of labor force, and (6) political stability, safety.

Japan recognizes the necessity to improve relatively inferior climate of investments by means of economic restructuring which includes a drastic reform of financial system, so called "Big Bang." Such deregulations are expected to stop Japan's industrial emasculation and activate the economy.

Investments and Taxes

Tax incentives for investments are special depreciation for capital investments, tax credit, advanced depreciation, and some others, however these incentives are equally applied to domestic and foreign companies.

Tax incentives given only to foreign investments are limited to tax credit for carry forward of operating loss for 10 years, additional depreciation, and so forth, however they are applied not all but only to specific foreign companies. Thus, taxation system in Japan is not very much in favor of foreign companies.

Currently a reform of corporate income tax is being discussed in Japan with the viewpoint that taxation on corporation is heavier in Japan than that of other countries, and this heavy burden seems to be one of the elements which weaken the international competitiveness and cause industrial emasculation. One of the proposals for reform is the reduction of corporate income tax rate of 37.5% currently applied by 2 to 3%. The reform also plans to abolish or minimize tax-free reserves so that the tax base is expanded. The burden of local business tax is planned to be decreased as well.

Japan is suffering from huge financial deficit. Therefore, decreasing tax burden by a reform of corporate income tax is a significant issue. In addition, there is a voice of fear that the consumption tax rate might increase to fill up the shortage of tax revenue caused by the reform of corporate income tax. Long time seems to be required before Japan implements a drastic tax reform.

Investments from Asia

Although more than 80% of foreign capital-affiliated companies in Japan have parent companies in the United States or Europe, the proportion from Asia is gradually rising. Rapid economic growth and improved competitiveness in Asia underscore the strong potential for Asian exports to Japan. Locating in Japan has tremendous advantages, given the size of the market, its leading economic position and favorable geographic location. Therefore, investment in Japan by Asian companies will be increasing.

NOTE:
This paper was presented at the AOTCA seminar held in Philippines on 7 November 1997.

BASIC FACTS ABOUT FOREIGN INVESTMENT IN KOREA

By Korean Association of Certified Public Tax Accountants

In principle, there is no foreign ownership limitation on direct investment in Korea. Likewise, a joint venture with domestic partners is not generally required to set up a business in Korea. There are, however, certain kinds of businesses to which foreign ownership limitations or activity restrictions apply. These include agricultural, forestry and fishery businesses, petroleum, mining, banking and financing, and business categories related with the national security or interest.

Businesses in the manufacturing sector are fully open to foreign investment with a few exceptions. Thus, in manufacturing businesses, it is safe to say that foreign investors can have a wholly owned subsidiary and exercise complete ownership.

Paragraph 3 -2 of Article 2 of the Foreign Capital Inducement Act defines inward direct investment, carried out with the aim of acquiring a lasting interest in the management of an enterprise, as follows:

Foreign investment shall mean subscribing to or holding stock or shares by a foreigner in an enterprise run by a judicial person of the Republic of Korea (including a judicial person under incorporation) or a national of the Republic of Korea in accordance with the Act.

According to the definition, acquisition of stocks of a corporation to be newly established or acquisition of an existing corporation by way of participation in capital increase will constitute inward direct investment. Thus only new issues of stock may be acquired in accordance with the Act.

In general, the corporate form preferred by foreign investors is the joint-stock company, though formation of a partnership company or limited liability company is possible.

Setting up a business in the form of a representative office or branch office does not constitute foreign investment under the Foreign Capital Inducement Act. Such investment shall not be accorded protections and privileges offered by the Act. A representative office which is not subject to corporate tax and registration requirements, is not allowed to engage in any commercial transactions. A branch office is subject to taxation for any income from sources within Korea.

The minimum capital requirement is 50 million Won of paid-in capital, amid 25% of the authorized capital must be paid in upon incorporation.

The first step in the incorporation of a joint-stock company is for three or more sponsors to prepare articles of incorporation. Then the sponsors subscribe to the shares amid transfer their paid-up stock money to a subscription handling bank, and, when the shares are to be offered to other persons, solicit stockholders. Since sponsors must be in Korea to handle incorporation procedures, and resident attorney or accountant may be asked to serve as the sponsor. Each of the sponsors must subscribe to at least one share, but may cease to be a shareholder by transferring his shares after the incorporation. Directors and auditors are elected by the sponsors (or, when the shares are offered to other persons, at the establishment meeting of all the subscribers).

The incorporation of the company must be registered by a representative director or by his proxy with the legal affairs bureau, whereupon business can be started. Such registration can be completed even when th amount of induced capital is less tha the approved (accepted) amount.

Under the Foreign Capital Induce ment Act, when a foreign investo wants to establish a legal entity i Korea, and intends to acquire stock thereof, the foreign investor must file a notification concerning acquisitio of stocks with the delegated banks o an approval application with a minister who has jurisdiction over the industry concerned. These notifications or applications must be filed by a resident of Korea who is designated as a proxy of a foreign investor or a foreigner is regarded as a resident of Korea if he resides in Korea over 6 months.

The types of business which require notification account for 95% of total businesses under the Standand Industrial Classification Code. Manufacturing businesses are of this type with a few exceptions. Over 80% of service businesses also require only notification.

To make a direct investment in Korea, a prior notification or an application for approval must be filed.

When the investment falls under the business categories on which restrictions are imposed, an application for approval must be filed with a minister who has jurisdiction over the industry concerned.

In the case of investments which are not related at all to those restricted categories, the notification of an investment plan is required in place of the approval application.

The notification is filed with delegated banks: 29 domestic banks (main office) and 40 foreign banks (domestic

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DEDUCTIBILITY OF EXPENSES UNDER SECTION 33, INCOME TAX ACT,1967: CAN WE REDUCE TAX BY DEDUCTING HYBRID EXPENSES?

By James Loh Ching Yew
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A Lawyer's Perspective.

(Being the basis for a talk to the Institute of Taxation, Malaysia).

INTRODUCTION

I need not remind you who are accountants, or tax consultants of the dichotomy between that which is revenue expenditure expended wholly and exclusively in the production say of business income, and that which is capital expenditure.

Section 33 of the Income Tax Act (the ITA) does not mention that the "outgoings and expenses" so incurred should be of a revenue nature although it refers to the annual period in which the expenditure occurs.

By implication therefore it can be argued that capital expenditure can also be incurred in the production of gross income. Thus Lord Reid in Commissioners of Inland Revenue v. Carron Company. 3 LTC (Leading Tax Cases), H.L. 1354 said at p. 1358-

"The main argument for the Crown was that by obtaining the new charter [a new constitution] the company obtained an enduring advantage [this expression being used with regard to capital expenditure] in the shape of a better administrative structure. Of course they obtained an advantage: companies do not spend money **either on capital or income account** unless they expect to obtain an advantage."
Emphasis is mine; and [square brackets] are my interpolations.

Lord Reid went on to delineate the general guides as to what amounts to revenue expenditure, and what amounts to capital expenditure. I have desisted from further quoting Lord Reid a very wise Judge because the aim of today's discussion is not to explain the differences between and the nature of capital expenditure and revenue expenditure.

What constitutes capital expenditure is for good measure non-deductible and Parliament has stopped up any possible loophole vide section 33, ITA by prohibiting deduction of capital expenditure under section 39, ITA.

All this is "old hat" to you and is mentioned by way of introduction so that we can now approach the question which is posed in the heading.

HYBRID EXPENDITURE AND WHY WE SHOULD TAKE NOTE OF THIS :

If the expenditure is capital expenditure the taxpayer often (but not always) obtains relief under the various schedules of the ITA e.g. the commonest being Schedule 3 which deals with the deductibility of qualifying capital expenditure on plant and machinery, and industrial buildings by granting deductible capital allowances, read together with section 42, ITA. Section 42 as you know confines the deductibility of the relevant capital allowances to the particular source of income to which it relates; e.g. plantation capital allowance is deductible only from the adjusted income accruing to or derived from the plantation business; and not say from the mining business each being separate sources of income on the facts of the particular case; see River Estates Sdn. Bhd. v. D.G.I.R. (1950-1985) MSTC, 64, P.C.

I need not remind you that capital allowances on qualifying capital expenditure are deductible only from the adjusted income already arrived at under section 33, ITA, i.e. the net income adjusted for tax purposes whereas revenue expenses are deductible from the gross income so as to arrive at the tax adjusted income.

As accountants and tax consultants this is your bread and butter when you compute the tax chargeability of your clients but I mention this so as to emphasize that from the purist point of view so long as it is capital expenditure, or revenue expenditure, relief is often available whether it be by section 33, ITA (in arriving at the tax adjusted income), or as capital allowances deducted from the tax adjusted income, under section 42. But what about the situation where controversy exists as to whether it is capital expenditure or revenue expenditure and I am referring to those cases where one comes across elements of both?

This is one form of hybrid expenditure - part capital and part revenue. Let me dispose of the other type of hybrid expenditure briefly.

It is illustrated by the case of Mallalieu v. Drummond (1983) STC, 665. H.L. where the dispute was over the question as to whether the expense was exclusively for the purpose of earning professional income, or partly for private purposes, the latter being nondeductible pursuant to section 39 (i) (a), ITA. The expense was disallowed because of the mixed purpose.

In the case of hybrid expenditure where it is part capital and part revenue the position in practice is to disallow the expenditure. The purist approach is adopted-either it is revenue or it is capital.

The disallowed expense is therefore **"added back" to the profit & loss account thereby being subjected to income tax.**

The result is that even though the expenditure is wholly and exclusively incurred in the production of say gross business income, there is no relief. The reason is not traceable to the word, "wholly". "Wholly" refers to the quantum of the expenditure (see. Bentley's Stokes & Lowless v. Beeson (1952) 33 T.C. 491, C.A. cited e.g. in Mallalieu v. Drummond.

What we are concerned with is with the quality and nature of the expenditure. And not with its quantum. If the expenditure e.g. comprises fifty percent revenue, and quite clearly fifty percent capital it will be disallowed, assuming one can estimate the proportions! What I am expounding upon is not a figment of my legal imagination. The problem has surfaced in modern times where the impact of technology on business has led to this hybrid situation giving rise to the problem that although it is a business expense wholly for business and exclusively for business it is nonetheless ruled out as being disallowable.

This of course is bad for the economy of a country like Malaysia for it serves as a disincentive to business activity. Businessmen are naturally concerned with the tax burden and if they cannot obtain relief despite the fact that the wholly and exclusively test has been satisfied then they may look to other countries e.g. Australia.

The observations of Lord Reid in C.I.R. v. Carron Company show that be it capital or revenue a business expense for a business advantage is nonetheless a business matter since it is not for private purposes.

It is time for me now to examine the case law consisting of leading cases on this question.

The Groundbreaking Case or Pioneering Case:
Commissioner for Taxes v. Nchanga Consolidated Copper Mines Ltd., (1964)I, All. E.R.P.C.

I have made so bold as to use the term, "hybrid expenditure". This term has not been used by Their Lordships in the leading cases I will be citing. But the Judges have indicated that there are borderline cases where differences of opinion might have harmful effects on business efficacy.

To begin with I propose to quote what Lord Radcliffe said at p. 212 of Nchanga' s case.

It is a long passage but to my mind it is a passage of seminal importance and has been referred to by other Law Lords in other leading cases, Lord Radcliffe said at p. 212.

"Judicial decisions have from time to time applied various tests in seeking to distinguish income from capital. There is the distinction between fixed and circulating capital resorted to by Lord Haldane in the case of *John Smith & Son v. Moore*[1] and, so long as the expenditure in question can be **clearly** referred to the acquisition of an asset which satisfies one or other of the accepted categories, as in the **ordinary** framework of a manufacturing or merchanting business; such a test must be a capital one. But at the same time, even putting aside the special circumstances of the extraction industries which regularly convert part of their fixed capital for which they have paid into part of their stock in trade which they sell, **there are many forms of expenditure which, though not falling easily within these categories, have nevertheless to be allocated to capital or revenue account** respectively in the ascertainment of profit and with regard to all these some other and rather different distinction has to be looked for.

Again courts have stressed the importance of observing a demarcation between the cost of creating, acquiring or enlarging the permanent (which does not mean perpetual) structure of which the income is to be the produce or fruit and the cost of earning that income itself or performing the income earning operations. Probably this is as illuminat-

[1] (1921)2 A.C. 13; 12T.C.266

ing a line of distinction as the law by itself is likely to achieve, but the **reality** of **the distinction, it must be admitted, does not become the easier to maintain as tax systems in different countries allow more and more kinds of capital expenditure to be charged against profits by way of allowances for depreciation, and by so doing recognise that at any rate the exhaustion of fixed capital is an operating cost**. Even so, the functions of business are capable of great complexity and the line of demarcation is sometimes difficult indeed to draw and leads to distinctions of some subtlety between profit that is made 'out of' assets and profit that is made 'upon' assets or 'with' assets. It does not settle the question, for instance, to say merely that an expenditure has been made to acquire a 'source of income', as the appellant says here, unless one is clear that some forms of circulating capital itself e.g., labour, raw material, stock in trade, are not themselves to be regarded as such a source".
Emphasis is mine.

This passage has also been quoted (as above) in Whiteman on Income Tax. 3" edition, (1988) at p.250, probably the leading book on income tax law.

You will note certain significant features of this passage viz-

(i) for accounting purposes you simply have to allocate some items to capital account, and some to revenue account; this is conventional wisdom and is part of your bread and butter;
(ii) there are however, many borderline cases and the legislature recognising that what is allocated to capital account is not deductible has introduced capital allowances thereby **blurring** the distinction between capital expenditure, and revenue expenditure for businesses where **the "exhaustion of fixed capital"** or depreciation is, **"an operating cost"**.
(iii) "circulating capital" may itself be deductible expenditure.

If one reads therefore between the lines and tries to understand the subtle implications, one realizes that Lord Radcliffe is trying to persuade us that the categories of the capital versus income syndrome not only are not closed but that that the boundaries must now in borderline situations give way to hybrid situations: thus operating cost which arises from the exhaustion of fixed capital that is to say depreciation, is nonetheless a **business** expense no matter that for the purposes of accounts i.e. tax adjusted accounts they are not deductible although as you know better than myself, depreciation as an item of expenditure is deductible from the gross profits in the **commercial** or **business** accounts.

This hybrid situation should therefore be regarded as a sort of twilight zone, or as the breaking of dawn where keener perception is required to discern the shape of things instead of closing one's eyes on the ground that one cannot discern in the half-light the capital tree from the income fruit.

I have sought to explain Lord Radcliffe's passage by indulging in categorical imperatives, I being of a lesser mind. Let it be noted that British judges when seeking to initiate a sea change in the law or in legal perceptions do so not by simply waving the legal wand as I have perhaps been guilty of but by allowing creeping doubt to seep into one's conventional perceptions of law.

Indeed the need for a sea change had become so pressing that Lord Radcliffe at p. 213-I said with relative stark simplicity -

> "Nchanga's arrangement ... out of which the expenditure arose, made it a cost incidental to the production and sale of the output of the mine. As such **its true analogy is with an operating cost**".

Lord Radcliffe is well known for his juristic analysis of the law thereby laying bare its underlying legal philosophy.

His Lordship e.g. did so in Kasumu v. Baba-Egbe (1956) 3. All E.R. 266, P.C. with regard to the law relating to money lending; and also in Kok Hoong v. Leong Cheong Kweng Mines Ltd. (1964) M.L.J. 49, P.C. with reference *inter alia* to the law of estoppel *vis a vis* the social policy of the legislation in question.

Lord Radcliffe's thoughts on the overlapping of capital expenditure, and revenue expenditure in these borderline situations has proved to be a source of inspiration in a subsequent case and it is now appropriate to consider the next case.

B.P. Australia Ltd v. Commissioner of Taxation of the Commonwealth of Australia, (1965) 3, All E.R. 209, P.C.:

Lord Radcliffe did not have to wait long for his inspirational nudging to take effect. In B.P. Australia, the Privy Council cited Nchanga's case, i.e. Lord Radciffe's judge-

ment and applied it. Note that B.P. Australia was decided approximately only eighteen months after Nchanga's case. Eighteen months does not at all represent a long period of gestation as Judges who decide to adopt an activist role will wait for change to be made manifest before moulding the law to suit changing conditions.

Perhaps this rapid transition was accelerated by the presence of Lord Morris, and Lord UpJohn in the BP Australia case: these two Law Lords together with Lord Radcliffe decided the appeal in the Nchanga case.

As in Nchanga's case Their Lordships dealt with the question of capital expenditure verses income expenditure. But as in Nchanga's case also Their Lordships were faced with the question of deductibility in borderline situations where elements of capital expenditure, and revenue expenditure overlap. And where the expense in question was it is to be emphasised, a business expense.

Their Lordship's quoted also a portion of the passage from Lord Radcliffe's judgement as to tax systems in various countries allowing "more and more kinds of capital expenditure to be charged against profits...".

This was the touchstone for the subtle change in mental approach of Their Lordships when at p. 218 of BP Australia, Lord Pearce delivering the judgement of the Privy Council opined -

"The solution to the problem is not to be found by any rigid test or description. It has to be derived from many aspects of the whole set of circumstances some of which may point in one direction, some in the other. One consideration may point so clearly that it dominates other and vaguer indications in the contrary direction. It is a **commonsense appreciation** of all the guiding features which must provide the ultimate answer. Although the categories of capital and income expenditure are distinct and easily ascertainable in obvious cases that lie far from the boundary, **the line of distinction is often hard to draw in borderline case** and **conflicting considerations** may produce a situation where the answer turns on questions of **emphasis and degree**. That answer -

> "depends on what the expenditure is calculated to effect from **a practical and business point of view rather than upon the juristic classifications of the legal rights**, if any, secured employed or exhausted in the process".
>
> (per DIXON, J., in *Hallstroms Proprietary, Ltd* v. Feder Comr. Of Taxation (2) (1946) 72 C.L.R. 634 @ p. 648. Emphasis is mine.

It will be noted that the business expense test is now to b adopted following both the pragmatic and scholarly ap proach of Lord Radcliffe, and Dixon C.J. another ver distinguished Judge. It is the business expense test whic is the convergence point of the capital, and revenue spheres The cellular walls separating both have now become po rous.

It is true that Their Lordships did not specifically refer t mixed expenses but it should be noted in the passage quoted above from the judgement of Lord Pearce tha "conflicting considerations" should lead one to base one's reasoning on differences of "emphasis and degree".

This means that in a borderline situation where there are both capital expenditure and revenue expenditure elements one should apply the business efficacy test rather than demarcate or compartmentalize the distinction between both types of expenditure.

Before I quote a further passage from BP Australia which vividly illustrates Their Lordship's thinking as to why one should adopt the business expense test it would be useful to outline the facts in both Nchanga' s case, and BP Australia.

The Brief Facts in Nchanga's case, and BP Australia

In Nchanga's case, a group of three copper mining companies was experiencing a fall in copper prices in the international market so they came to an arrangement to restrict in fact to cease the output of one of the companies for one year, so that the remaining companies would benefit by decreased output consequent on the first-mentioned company's temporary cessation of output.

Remember the Stevenson Rubber Restriction Scheme of the early thirties?

These companies, however, were rival companies and so there had to be a **quid pro quo** or trade-off: a sum was paid to the first-mentioned company (the cessation-company I will so call it) by way of compensation. The taxpayer-company which paid this sum together also with other paying company sought to deduct this lump sum from its trading receipts for taxation purposes.

The attempt at deductibility was disallowed by the Revenue which regarded the compensation as capital expenditure.

In BP Australia, which is one of the petrol-tie cases which have come before the Courts, BP Australia supplied petrol to certain stations which resold the petrol to the public.

One of BP Australia's rivals sought to oust BP Australia by introducing a system of tied garages so that BP Australia's retailers would be wooed away from BP Australia. And indeed it worked with many of the petrol retailers.

So to fight off this competition BP Australia in turn introduced a system of securing the custom of the retailers through the tied system: BP Australia would pay lump sum payments over a period of five years to the retailer-stations for the improvement of their service stations. The lump sum payments were no doubt for the purpose of securing the custom of the retailers by tying them to BP Australia. BP Australia sought deductibility of these lump sum payments in arriving at its taxable profits. However, the Revenue disallowed the expenditure on the grounds that it was capital expenditure.

As practitioners who probably have been losing most of your tax appeals in recent years, you will no doubt be heartened to note that the taxpayer won in both Nchanga's case, and BP Australia. It seems to me that the problem in Nchanga's case was less difficult of resolution than in BP Australia. Thus in Nchanga's case the Privy Council upheld the unanimous decision of the Federal Court of what was then Rhodesia and Nyasaland; whereas in BP Australia, the Privy Council reversed the split decision of the Full Court of the High Court of Australia (three of the Australian Appeal Judges upheld the decision of the High Court below; and two of the appeal Judges would have reversed it) and ah owed the appeal of the taxpayer.

The purpose, I have said of this discussion is not to discuss the difference between capital expenditure, and revenue expenditure so I will eschew an analysis along these lines. The "conflicting considerations" can be found described e.g. at pp. 217 & 218 of BP Australia.

What I wish to highlight is that after weighing and considering the conflicting considerations Their Lordships applied the business efficacy test.

The Ultimate Touchstone : Practical Business Wisdom :

Thus at p. 218 of BP Australia, Lord Pearce referred to the fact that in 1951 the trade of marketing petrol "changed its nature but for sound commercial reasons. This said Lord Pearce was "in accord with modern tendencies in commerce". And giving reasons as to why a payment which was evidently a blend of revenue, and capital should be deductible, His Lordship reasoned at p. 222 as follows:-

> "It is of commercial importance that profits should not be inflated for tax purposes by the **artificial** withdrawal from the profit and loss account of expenditure directly incurred in earning unless it is of a **truly** capital nature. There is force in the observation of the Lord President (Lord Dunedin) in Vallambrosa v. Farmer (Surveyor of Taxes) [1910, 5. T.C. @ p. 535; 3, Leading tax Cases, 889, at pp. 891 & 892.]:
>
> ".... The Crown will not really be prejudiced by this, because when the tree comes to bear, the whole procedure will go to the credit side ..... the only deduction will be the amount which will be spent on the tree in that year; **they will not be able to deduct what has been deducted before**."
> Emphasis is mine.

Certain lessons may be learnt from this very important passage :

(1) if businessmen are not allowed a deduction of a business expense because after being faced with "conflicting considerations" and because the Revenue decides in a borderline hybrid situation that the expense is of a capital nature then the businessman will be taxed on this expense notwithstanding that it is wholly and exclusively incurred in the production of their gross business income ; this of course is a disincentive . This will go on in succeeding years: the capital expense is added back to profit for tax purposes.

(2) if the particular expense is allowed as a deduction, the Revenue will not be prejudiced as explained above by Lord Pearce, quoting Vallmbrosa. The Revenue will tax the incomes year after year; and the same expense once deducted cannot be deducted again.

(3) a liberal and reasonable approach should be adopted by the Courts so only where one is satisfied that the hem of expense is "**truly** capital" e.g. in ordinary and reasonably clear situations, should the expense be disallowed.

In support of this line of reasoning of the Privy Council Lord Pearce suggested at p. 222 that one of the matters to be considered was that "the ordinary principles of **commercial** accountancy" should be applied. Emphasis is mine.

And His Lordship's succeeding comments in the same page highlights the difference in regard to a hybrid or mixed payment - it would be an operating cost; His Lordship in fact uses the word, "depreciation" which "had gone directly to earn the taxable profits"; it may be e.g. "intermittent recurring expenses" but would be disallowable. And His Lordship comes down in favour of allocating the expense "it would be slightly preferable" to revenue account in a situation of "conflicting considerations". It will be seen therefore that the Privy Council has eschewed the doctrinnaire and purist method of analysis and preferred practical business analysis and commonsense in borderline situations.

Thus in Nchanga's case at p. 212 of (1964) 1. All E.R. the Privy Council warned against using general guides by converting them into catchphrases, like "enduring benefit", "capital structure". "This very warning was echoed at p. 216 of BP Australia where thee Privy Council applied Lord Radcliffe's warning: Lord Radcliffe took the trouble to narrow down the application of the well known case, British Insulated & Helsby Cables v. Atherton which has been interpreted to mean that if it is of "enduring benefit" then the expense is capital expenditure.

Thus in Nchanga's case, His Lordship disposed of the phrase, "enduring benefit" in the following terms

> "..... while it is certainly important that in Atherton's case expenditure that did secure an enduring benefit for a company's business was spoken as being for that reason a capital expenditure, it would be **a misuse of that authority to** suppose that it gives any warrant for the idea that securing a benefit for the business is *prima facie* capital expenditure so long as the benefit is not so transitory as to have no endurance at an". Emphasis is mine, see p. 212-D.
>
> In BP Australia at P. 218-D, Lord Pearce thought along the same lines and cautioned that the principle in Ahterton's case was ".... an expression of general principle on *prima facie* indications".

Another case where Atherton's case was limited to being only a general guide not necessarily applicable to eve "enduring benefit" case was Tucker v. Granada Motorw Services (1979) STC, 393. H.L. Lord Fraser at p. 403 limited the application of Atherton' s case in the followi terms -

> "In the present case the fact that the payment is mad once and for all is an indication, though not a conclu sive indication, that the payment was of a capit nature. But the second of the Atherton test seems to m inappropriate in respect that it tends to concentra attention too much on the reason why the expenditur was incurred ('with a view to' what purpose?). A mor relevant test in the present case is to see for what th payment was made."

I promised you earlier that I would not dwell on the distinction between capital, and revenue expenditure, and I highlight the Atherton test to indicate to you that certain sacred cows should now be reexamined; they are not the golden calf around which to prance but merely serve as pointers.

The reason is as explained in Nchanga's case - a case which finds its resonance (by way of (citation and pronouncement) in Granada Motorway Services is that the complexities in modern commercial life have had their impact resulting in new forms of expenditure. As Lord Radcliffe observed in Nchanga' s case at D. 212-1 and 213-A:-

> "....the functions of business are capable of great complexity and the line of demarcation is sometimes difficult to draw.....".

Thus in Regent Oil Co. v. Strick 1965 (3) All E.R. 174, H.L. the House of Lords went to great pains to delineate the special features of that case and to distinguish it from BP Australia.

Regent Oil Co. Ltd. V. Strick

I will pay some attention to this case lest it becomes the fashion to quote it against taxpayers. Let it be noted that whosoever quotes Regent Oil Co. Ltd. it should be done in conjunction with BP Australia and also Mobil Oil Co. Ltd. V. Commissioner of Taxation of the Commonwealth of Australia, (1965) 3, All E.R. 225, P.C.

There are certain features common to all these three cases (the petrol tie cases) viz. Regent Oil Co. Ltd. V. Strick, BP

Australia v. Commissioner of Taxation, and Mobil Oil Australia v. Commissioner of Taxation which invite comparison:-

(I) All three cases were decided by the same Judges, Regent by the House of Lords, BP Australia and Mobil Australia by the Privy Council;

(II) All three were heard in the middle of 1965; and the last day of hearing (presumably the day when judgement was (delivered) was the same for all these cases, namely 27th July 1965;

(III) All three cases were petrol-tie cases with payments made for the purpose of securing the custom of petrol stations as explained previously.

In Regent, the House of Lords decided for the Revenue, whereas in BP Australia, and Mobil Oil Australia, the Privy Council decided in favour of the taxpayer.

With regard to BP Australia, Lord Pearce at p. 227, of Mobil Australia noted that

> "The arguments in all the Courts have been similar to those in BP Australia Ltd. v. Commissioner for Taxation of the Commonwealth of Australia **since the facts of these two cases are very similar**".
> Emphasis is mine.
>
> The same was not said of Regent oil Co. Ltd.
>
> It is increasingly clear that to merely cite Regent in support of one's decision without even mentioning BP Australia **and** Mobil Oil Australia is to invite the criticism that reliance on Regent is based on ignorance of BP Australia **and** Mobil Oil Australia.
>
> On my part I find it difficult to conceive that any reputable textbook writer who cites Regent would leave out BP Australia when citing Regent see e.g. pages 283-285 of Whiteman on Income Tax, 3rd edition.

Finally as in BP Australia the Judges in Regent resonated with the judgement in Nachanga's case as to the need for pragamatism and the business eficacy test in borderline situations where it is difficult to demarcate the borderline.

Since Regent has been brandished as a wand with which to mesmerise appellants in tax appeals (in Malaysia) I shall spend a bit of time specifying those portion of Regent which are along the same lines as Nchanga's case, and BP Australia. Before doing so, however, it is necessary to highlight those material facts which compelled Their Lordship to distinguish between Regent, and BP Australia.

Regent also illustrates a petrol-tie arrangement but in Regent the oil company which entered into the petrol-tie arrangements was less astute from the view point of tax planning than BP Australia and Mobil Oil Australia.

In Regent, the Regent Oil Co. which was one of the major oil suppliers of the United Kingdom in order to secure the custom and commercial loyalty of certain petrol stations, entered into the following lease and sublease back arrangement:

Regent entered into a lease from the proprietor of the petrol station, and then subleased it back.

As Lord Reid explained at p. 178-

> "The essence of this new form of tie (His Lordship was aware of the type of petrol-ties in BP Australia, and Mobil Oil Australia) is that the garage owner (petrol station) grants to the oil company a lease of his premises (or at least that part containing the petrol pumps and storage tanks) for the agreed period of the tie. The considerations for this lease is the agreed lump sum payment (described as a "premium) plus a nominal rent of £1 per annum. On the same day the oil company then grants to the garage owner a sub-lease of the same premises for the same period less three days, the consideration for the sub-lease being the same nominal rent of £1: but the sub-lease contains covenants or conditions whereby the garage owner is bound to buy the petrol which he needs for resale for that on company and from no one else. The net result is that no money passes except the agreed lump sum and the oil company gets its tie; but this machinery is not a sham..... if the garage owner defaults, this new form of tie gives the oil company a better way of enforcing its rights by bringing the sub-lease to an end and by standing on its rights under the lease. I should add that in two of these four cases the lump sum are expressly stated to be premiums while in the other two they are not, but I do not think that makes any difference."

His Lordship then at p 179 of Regent went on to deal with the difference between the commercial accounts the aim of which was "to give as fair and accurate a picture as possible of the trader's financial position," and on the other hand the tax adjusted accounts where the wasting or deprecia-

tion of a capital asset as an expense cannot be deducted from the tax adjusted accounts because of statutory intervention.

It will be seen that unlike BP Australia and Mobil Oil Australia, in Regent the taxpayer company obtained an "interest in land" (p. 187-B of Regent).

An interest in **land** namely the lease granted to Regent Oil Company is a capital asset and it is this feature which marks the big difference between Regent and the Australian cases (BP and Mobil). Lord Reid at p 187-B regarded this as a " highly relevant factor". Thus Lord Morris also at p. 187 commented,

> "I agree with the view expressed by the learned judge and by the Court of Appeal that the taxpayers acquired interests in land and that such interests were of a capital nature. I also agree that in the circumstances of the present case the payment made to acquire those interests must be regarded as payments of a capital nature."

See also the judgement of Lord Pearce at pp. 193, p 194 & p.196 bottom per Lord Upjohn- purchase of land is purchase of a capital asset except where it is stock in trade in the hands of a property dealer; furthermore the lease and sublease back were not a "mere cloak" but were entered into to secure the trade of Regent Oil Company.

This distinction resting on the acquisition of an interest in **land** is also the view of Whiteman on Income Tax, p. 284, 3rd edition.

Regent Oil Company v Strick therefore must rest on its own peculiar arrangement between the oil supplier and the garage owners. This peculiarity was forced upon the taxpayer company by certain garage owners who insisted on receiving lump sum payments which in their hands would be capital receipts; p 194-B, this was to enable them to avoid income tax. Regent oil company which was facing fierce competition had no option but to comply although as Their Lordship indicated at pages 192-F, 193-C and page 205-C from the tax planning point of view the arrangement which Their Lordships emphasized was not a sham or cloak but arose out of trading requirements, could have been structured in another manner.

Another distinction between Regent and the Australian cases was as put by Lord Wilberforce at p.201-H -

> "They were lump sums paid **at the start** of the transa tions to procure the **immediate emergence** of an ass or advantage, enjoyment of which was secured for period." So in the hands of the petrol station propr etors it was a capital asset.
> Emphasis is mine.

Nevertheless the deciding factor was that the payment were for the acquisition of an interest in land by taxpaye which was not a property dealer.

Same Line of Approach in Regent Oil Co. Ltd. v. Strick a in B P Australia, and Mobil Oil Australia:

I hope I have succeeded in preventing any attempt to regard Regent as being in conflict with BP Australia, and Mobil Oil, Australia, guided by judgements of Their Lordships in these cases.

The decision in Regent had perforce to be different from the decisions in BP Australia, and Mobil Oil Australia because of the material divergence in facts.

At the same time those who seek to use Regent as an authority with which to deny taxpayers deductions, should take heed that in all these three cases the approach was the same i.e. to eschew doctrinaire and purist solutions which sometimes do not fit into business situations. Thus Their Lordship took time to explain and limit the application of Atherton's case: at p. 183 of Regent Lord Reid explained that it was "essential to have the facts in mind". With reference to the pensions fund set up by the taxpayer company for its employees, Lord Reid emphasised that the payment by the taxpayer company into the fund, "was made literally once and for all **and** where the asset or advantage was to last as long as the company lasted". Emphasis is mine. So the payment was capital expenditure.

So Atherton is no longer to be regarded as an infallible all weather legal barometer for, " arbitrary rules are quite out of place in this matter of capital or income"; p. 184-E of Regent.

The term, "enduring benefit" which is taken from Viscount Cave's judgement in Atherton can no longer be tossed around as the single touchstone because there is no single touchstone (p. 188-E Regent). See also per Lord Morris at p. 188-H Regent and per Lord Upjohn, at p. 198-G of Regent.

Having disposed of the doctrinaire approach Their Lordships, e.g. Lord Wilberforce in Regent quoted from the judgement of Dixon J. in Hallstroms Proprietary LTD. v. Federal Commissioner of Taxation (1946) 72, C.L.R. 634 at p. 648 to the effect that one should adopt the "practical business point of view"- see p. 201-F of Regent. This approach too if it be remembered- was adopted by Lord Pearce in BP Australia, p. 218 and already referred to in this discussion.

See also p. 203-E & F

Atherton, however, has not been relegated to the lumber room of secondary concepts. One of the difficulties I have faced in gauging the extent of the sea change in the law is that the enduring benefit test - in the mind of Lord Wilberforce - was the final touchstone albeit after considering the "business reality" and after adopting the "practical and business point of view". His Lordship at p. 203 in applying the practical and business test concluded that the leases-sublease back arrangement was a complex right of enduring quality. Lord Wilberforce in Tucker v. Granada Motorway Services (1979) STC 393 . H.L. also refrained from restricting the application of Atherton. But His Lordship also cautioned that Atherton was no longer "regarded as having quasi-statutory force" – p. 396-F &: G.

Actually the difference if any-between Lord Wilberforce and the other Law Lords was not substantial but one of degree.

His Lordship's comment at p. 204 of Regent seems to make this reasonably clear-

> "..... The principle seems to emerge that if on a consideration of the nature of the asset **taken together with other relevant factors**, leaves tile matter in doubt to have regard **amongst other things**, to its transient character."
> Emphasis is mine.

There is a subtle difference of emphasis between this approach and that of Lord Radcliffe at p. 212-D of Nchanga's case: already quoted. This is because Lord Radcliffe with his analogy as to "operating cost" was closer to the situation representing hybrid payments.

What is the Borderline Between Capital Expenditure, and Revenue Expenditure?

Whether one is a practitioner, Revenue official or for that matter a Judge, this question will haunt one. As the learned authors of Whiteman on Income Tax, 3rd edition, at p. 284 say,

> "...both cases [BP Australia, and Regent] leave unanswered the questions of where the borderline between capital and revenue payments is to be drawn where no leasing arrangements are involved".

But what about those situations where there are cases **on** the borderline?

It is my submission that it would be unduly academic to engage in excruciatingly difficult discourses and distinctions so as to try and ascertain the boundaries in the half light. This is referable to that area of no-man' s land where what matters are intuition and observation as to the business activities of practical businessmen.

I am fortified in this by quoting what Lord Upjohn said in Regent at p. 199-E:

> "How, then, is this problem to be solved my lords there is one matter on which both sides are agreed. That it is the duty of the court to consider every relevant fact, giving it its due weight and then to reach a conclusion on the whole matter. I cannot but recall the observations of Sir Wilfred Greene, M.R. in Inland Revenue Commissioners v, British Salmson Aero Ennines Ltd (1938, 1 All E.R.283 at p.283) where he said,
>
> 'There have been many cases which fall **on** the borderline. Indeed in many cases it is almost true to say that the spin of a coin would decide the matter almost as satisfactory as would an attempt to find reasons.'
>
> Somewhat cynical but **true**. It is a question of fact and degree and above all judicial commonsense".
> Emphasis is mine.

The reference to "many cases" shows that this is not a predominantly academic exercise but a practical problem of pressing importance.

Different Judges will probably arrive at different conclusion in regard to these on the borderline cases leading to disquiet and dissatisfaction. And on the aspect of public policy this unsatisfactory state of affairs will mean a disincentive to investment in the country.

What attracts investment - both local and foreign - is that

there should be a level playing field with the goalposts clearly discernible. This is possible where the borderline can be ascertained by Their Lordships. However, as regards on the borderline cases it is my submission that this is not possible within the realm of reason and as practitioners especially legal practitioners you are no doubt used to the practice of warning clients in such situations that the determinative solution would be the sympathies of the Judge that is to say His Lordship's mental inclinations. It is further submitted that hybrid expenditure or payments feature in **on** the borderline situations. Disputes, however, have to be resolved one way or other and in my view Lord Radcliffe has indicated the methodology of thinking which should be adopted.

The On the Borderline Situation Involving Hybrid Payments : What is the Cost of Earning the Income?:

The fact that expenditure occurs once and for all does not mean that it is necessarily capital as and see Nchanga's case, nor the fact that it recurs is it necessarily revenue as the payment of lump sum payments can be structured so that they are paid over a period of time.

In the passage already quoted from Nchanga's case the practical business test was evidently applied for Lord Radcliffe and his fellow Judges indicated that the line of demarcation is not to be compartmentalized but the question is whether the cost is an operating cost (p.212-1; or something which is " truly **analogous** to an operating cost "-p. 213-H. Emphasis is mine. The privy Council therefore adopted the following guide of Lord Sumner in Smith (John)& Sons v. Moore (1921)2 A.C/13, at p. 39.

> "The compensation paid [by Nchanga] .... resembled much more closely .... an outlay of a business in order to carry it on and to earn a profit out of this expense as an expense of carrying it on".

Reading the whole judgement I would interpret this to mean that so long as it is analogous to an operating cost and is incurred to earn a profit on the business and to carry on the business, then it is deductible no matter that is a hybrid payment comprising elements of capital, and revenue expenditure.

To attempt to trace the tortuous borderline between capital expenditure, and revenue expenditure in on the borderline cases may be likened to marking the course of a sinuous river meandering through virtually impassable mountain passes. It would mean departing from the standard set b Lord Wilberforce in Ben Odeo v. Powlson (1978) STC 46 H.L. at p. 464 -

> "An important principle of the laws of taxation is tha in the absence of clear contrary direction taxpayers i objectively, similar situations should receive simila tax treatment".

This is a legal manifestation of the level playing field concept with discernible goal posts.

The administration of tax and the adjudication of tax disputes has an important impact on the economy of the country, and I have no doubt that if one does not apply the practical business test in on the borderline cases but instead seeks to wave the legal wand by employing catch phrases as the be all and end all. we will end up not only with conflicting decisions but confusing guides. In such a situation, however, well intentioned and intellectually honest one may be the result is a lack of consistency or even impartiality in the administration of justice and law.

I have quoted learned judicial and legal comments to you. As we are dealing with business income and our clients are in this connection businessmen with practical problems let me quote to you what a businessman quite recently said viz-

> "... Mr. Richard Li, a prominent Hong Kong ...businessman, told a London conference: The cornerstone of Hong Kong's commercial success, and its ability to create wealth-creating capital, has certainly been the existence of a independent and impartial legal system.
>
> Coupled with a sound administration, it has provided entrepreneurs and investors with a level playing field. It is for the reason one of the most significant contributions to Asia's development, and is very much to Britain's credit". Financial Times, 7th March, 1994.

As practitioners you may well ask this speaker; and how do you propose to implement what you consider to be the business approach?

The Suggested Approach:

I will begin first of all stating that the Income Tax Act 1967 does not prohibit the deduction of hybrid payments so long as they are wholly and exclusively incurred in the production of gross income pursuant to section 33 of the

ITA. And 39(l)(b) of the same reads as follows -

"s.39(1) ..... no deduction from the gross income from that source for that period shall be allowed in respect of-

(b) any disbursements or expenses not being money wholly and exclusively laid out and expended for the purpose of producing the gross income."

True, section 39(1)(c) prohibits the deduction of capital outgoings but a hybrid payment on the borderline is not a capital expense; it is *sui generis*.

As for section 33, ITA it refers to a year of assessment and income tax as an annual tax.

The conventional wisdom that section 33 refers to revenue expenditure. The reasoning seems to be that that which is not capital is of a revenue nature. I suspect that this is attributable to the accounting requirement of allocating expenses either to capital account or revenue account in the computation of the tax adjusted accounts. There is no such thing as a hybrid capital cum revenue account.

This however, when we deal with the law in real life that we come across grey areas and I daresay that a great deal of litigation is over these grey areas. Needless to say that which is grey is neither black nor white.

Assuming that section 33, ITA refers only to revenue expenditure the argument would be that the Act is silent on hybrid expenses so judicial wisdom and judicial commonsense have a crucial role to play. It is one of the tax legal axioms in the law of taxation that tax can be imposed only by law, i.e. by legislation passed by parliament.

As Lord Goff said in Woolwich Building Society v. I.R.C. (1992) STC. 657, H.L. @ p. 677, bottom-

> "the retention by the state of taxes unlawfully exacted is particularly obnoxious, because it is one of the most fundamental principles of our law ...that taxes should not be levied without the authority of Parliament"

In Malaysia the principle is enshrined in Article 96 of the Federal Constitution -

> "96. No tax or rate shall be levied by or for the purposes of the Federation except by or under the authority of federal law."

As you know, expenses and outgoings etc. which are not deductible or held to be not deductible by the Revenue (either as revenue expenditure, or as capital allowance will be taxable they are added back to the profit & loss account of the tax accounts. So if hybrid payments are held to be not deductible that would amount to an imposition of taxation not authorized by legislation.

The legislation in question (the ITA) follows the convenient and compartmentalised thinking of rigidly allocating items to capital or revenue account. Silence on the part of the legislature is not authority to impose taxation.

As Lord Wilberforce said in Vestey v. I.R.C. (1980) STC, 10 @ p. 18(h) & (j): as quoted by Whiteman on Income Tax (3rd edition (1988) at p. 45:-

> "Lord Wilberforce emphasised in Vestey v. I.R.C. (1979) 54 TC 503 @ p. 581; (1980) STC 1D, @ p. 18 (h) (7) that a taxpayer is only chargeable to tax if the statute clearly imposes a liability to tax on him and that the existence of a charge and its extent are matters for the legislature, not for any administrative body, for example, the Commissioners of Inland Revenue:
>
> > "Taxes are imposed upon subjects by Parliament. A citizen cannot be taxed unless he is designated in clear terms by a taxing Act as a taxpayer and the amount of his liability is clearly defined. A proposition that whether a subject is to be taxed or not or, if he is, the amount of his liability, is to be decided (even though within a limit) by an administrative body represents a radical departure from constitutional principle. It may be that the Revenue could persuade parliament to enact such a proposition in such terms that the courts would have to give effect to it: but unless it has done so, the courts, acting on constitutional principles, not only should not but cannot validate it."
>
> Emphasis is mine.

In BP Australia, Mobil Oil Australia, and Nchanga's case, if the payments had been disallowed by Their Lordships there would have been no relief they would have been regarded as capital payments in respect of which there would have been no capital allowances.

Nor is it possible to apportion the extent of what is capital expenditure and what is revenue expenditure - in real life a blend of capital cum revenue expenditure is not a test

tube concoction.

With the growing emphasis on service industries there will increasingly be payments for commercial favours and financial *quid pro quos* etc. commercial arrangements not only in industry and commerce but in the expanding financial services sector.

There will be many hybrid payments which are expenses wholly and exclusively incurred for the purpose of producing income.

So my proposal is that when tax consultants and accountants prepare their tax computations they allocate such hybrid payments to revenue account so long as they are wholly and exclusively incurred for the production of the business income.

In the event of their being tax litigation it is my earnest hope that Their Lordships will also take the same line as regards on the borderline cases instead of vainly trying to ascertain an elusive gossamer - like thread which is supposed to demarcate the boundary between capital expenditure, and revenue expenditure.

I would also hope that in borderline cases i.e. cases which just touch the borderline this same approach be adopted for after all business income should not be taxed in respect of expenses wholly and exclusively incurred for the production of business income; unless of course it is reasonably clear that it is capital expenditure: they will be added back to the total profit and loss accounts.

If Their Lordships in Malaysia accept this line of approach they can still apply the law in accordance with the precepts of statutory interpretation as outlined above in Woolwich Building Society, and Vestey for where there is silence in a statute there is a no man's land where Judges are welcome to tread without attracting the criticism of engaging in judicial legislation,

Thus in a situation where there is a reasonable doubt as to whether the expense represents capital expenditure, or revenue expenditure because the nature of the expense is that it is a grey expense or hybrid expense it is respectfully suggested that Their Lordships give the benefit of the doubt to the taxpayer so long as the "wholly and exclusively" test is satisfied.

In National Land Finance v. D.G.I.R. (1994) 2. MSTC, 3368. S.C. the Supreme Court of Malaysia applied the reasonable doubt test on the question as to whether or not the relevant statutory provisions could be applied retrospectively and the Supreme Court therefore gave the benefit of the doubt to the taxpayer.

Another approach is for His Lordship - in an on the borderline case to pronounce with a straight face that the expense is indeed revenue expenditure or that it is truly analogous to an "operating cost". If an operating profit is chargeable to income tax then any expense which is "truly analogous to an operating cost" should consequently be deductible.

As a matter of update there is a very recent judgement by the privy Council in Wharf Properties Ltd. V. Commissioner of Inland Revenue 7th March. 1997, 334 W.L.R (Weekly Law Reports) which establishes that once a capital asset is acquired or created **and** is producing income the expense e.g. interest is the cost of earning that income. Their Lordships drew inspiration again from the judgement of Lord Radcliffe in Nchanga's case on this point, see p. 337 of the case report: it is submitted that this is with reference to Lord Radcliffe's test - that which is "truly analogous to an "operating cost" is of a revenue nature no matter that it savours also of an element of capital expenditure.

As a developing country, Malaysian society should adopt a more expansive and flexible approach towards taxation problems instead of relying only on what Lord Reid has described as "the old cases" at p. 179 of Regent. The configurations of business are inevitably going to be more complex and fluid given not only joint venture schemes but also globalisation of international trade.

The rigid compartmentalisation of accounting should no longer overshadow tax concepts in the world of business and law-either this or that or nothing.

Lord Radcliffe in Nchanga's case, and then Lord Pearce in BP Australia have shown the way by rejecting artificial distinctions in borderline cases. We have now a new compass to guide us. Let us as a developed country now adapt ourselves.

Note :

This paper was presented at a seminar which was jointly organised by the Institute and Malaysian Institute of Accountants on 12 June 1997.

High Court Appeals in Tax Cases

W.S.W. Davidson
Advocate & Solicitor

Rayuan No.PKR 670
Please see report of Special Commissioners appearing in the June 1997 issue of the Tax Nasional. The appeal was dismissed by the Special Commissioners. The taxpayer filed an appeal to the High Court against the decision. The Appeal was later withdrawn by the taxpayer.

Rayuan No.PKR 537
This case went on appeal to the High Court where Dato' Charles Ho sat as the presiding judge and the appeal was allowed with cost.

A report of the decision is contained here.

Rayuan No. PKR 654
The Special Commissioners decison appeared in the June 1997 issue of the Tax Nasional. The taxpayer has filed an appeal to the High Court against the decision.

This appeal came up for hearing before the High Court, Kota Kinabalu on 22 August 1997. The High Court pursuant to paragraph 39 Schedule 5 of the Income Tax Act 1967 has remitted the case back to the Special Commissioners for them to consider the arguments raised at the earlier hearing before the said Commissioners based upon section 33(1) of the Act and then state a supplementary case.

Rayuan No.PKR 673
The Special Commissioners decision appeared in the June 1997 issue of the Tax Nasional. The appeal has been withdrawn by the taxpayer.

IN THE HIGH COURT OF SABAH & SARAWAK AT KOTA KINABALU, SABAH
MISC. APPEAL NO. K 03/98

This was an appeal from the decision of the Special Commisioners of Income Tax upon a case stated under paragraph 34 and 35 of Schedule 5 of the Income Tax Act 1967.

ISSUE

The question for the determination of the Court was whether the interest paid by the taxpayer in respect of a second loan was allowable as deduction under Section 33 (1) (a) of the Income Tax Act 1967.

BACKGROUND FACTS

1. The Appellants' are wholly owned by the Sabah Foundation. Sabah Foundation was incorporated under the Sabah Foundation Enactment, 1966.

2. The Appellants' sole business operation was extractional and sale of timber logs for which they must have a timber license from the State Forestry Department.

3. The Appellants had to pay a royalty to the State Government on all the logs sold. This payment makes up about 35% to 40% of the total expenditure of the Appellants.

4. The timber logs are both exported and sold locally. In respect of export sales, the transaction was done in US dollars.

5. The royalty payments remained outstanding because the Appellants faced cash flow problems arising from donations made to the Sabah Foundation and to other bodies.

6. In 1981, the Appellants applied for a loan from the Sabah Development Bank Bhd (hereinafter referred to as the "first loan"). The Bank approved a loan of RM70,000,000.00, on condition, inter alia, that the loan be used strictly for the payment of royalty.

7. The first loan was in fact utilized to pay royalty and as at 31st December 1981, an amount of RM84,013,227.50 was paid over to the State Forestry Department.

8. On 7th May 1982, the Appellants obtained another loan from the same bank for US $ 30 million (hereinafter referred to as the "second loan") to finance working capital requirements and investments in projects. The loan was applied for in US dollars because the Appellants wanted to take advantage of foreign exchange benefits and it also acts as a hedge against currency rate fluctuations.

9. On 12th May 1982, the Appellants informed the Bank of their intention to repay the first loan and with the approval of the Bank the second loan was utilized to settle the first loan to the extent of RM63,750,400.00. At that time, the Appellants had already started paying interest on the first loan and after repaying the first loan, the Appellants paid interest on the second loan.

10. The Respondent disallowed claims for deductions by the Appellant in respect of certain amounts of money paid to the bank as interest under the loan agreements relying on section 33(2) of the Act. The amounts of interest disallowed were as followed:-

	Interest
Y/A 1983	RM8,826,898.00
Y/A 1984	RM5,948,682.00
Y/A 1986	RM6,257,702.00
Y/A 1986	RM4,618,056.00
Y/A 1987	RM3,606,206.00

11. The issue that was to be decided by the Court was thus this:

"whether certain amount of interest paid by the Appellants in respect of the two loans taken from a bank for the payment of royalty are allowable as deductions in the computation of taxable income of the Appellants pursuant to section 33(1) (a) of the Income Tax Act 1967 for the years of assessment 1983-1987."

ARGUMENTS BY THE TAXPAYER / APPELLANT

It was contended on behalf of the Appellant that:-

a) The Appellants' case comes under the specific provisions of section 33(1) (a) of the Act. The Appellants do not have to rely on the general provisions of section 33(1) as confirmed by the decision of the High Court in the case of *DGIR v Rakyat Berjaya Sdn Bhd (1984) 1MLJ 248.*

b) The Appellants agreed regarding the meaning with the Special Commissioners decision to be given to the words "outgoings and expenses wholly and exclusively incurred during the period by that person in the production of gross income from that source".

(c) The Appellants' stated that the test adopted by t Special Commissioner based on the decision in *W & Co. v CIT (1922) AC 145*, that the expenditure m have been incurred for the direct purpose of produc profits, was too narrow. The Appellant argued th such a test would exclude expenditure indirectly curred for the purpose of producing profits. The A pellants also pointed out that the test applied in *War case* and by the Special Commissioners in the prese appeal has not been followed by the House of Lord the Australian High Court and our Federal Court.

d) Our Federal Court in *DGIR v Kulim Rubber Plantatio Ltd [1981]1 MLJ 214* adopted a wider test as pr pounded *in British Insulated and Helsby Cables Ltd Atherton (1926) AC 206*. The *Atherton test* reads follows:-

"a sum of money expended, not of necessity and with a vie to a direct and immediate benefit to the trade but voluntar and on the grounds of commercial expediency, and in orde indirectly to facilitate the carrying on of the business, ma yet be expended wholly and exclusively for the purposes o the trade. "

The High Court of Australia in *W Nevill and Co. Ltd v FC of T* followed the *Atherton test*.

e) The Appellants argued that the Special Commission- ers' view that borrowed money must be the cause o income and that the borrowing must come first was a sweeping and generalised statement of the Law un- supported by authorities.

f) Counsel for the Appellant also cited the case of *FC of T v JD, Roberts 92 ATC* 4380 at page 4587 where Hill delivering the judgment of the Australian Full Federa Court said:-

"The mere act of borrowing money, burdened with the obligation to pay interest, does not of itself gain or produce assessable income. The amount borrowed is not assessable income. What operates to gain or produce assessable income is the manner in which those moneys are used, so that the necessary connection between the out going for interest and the activities which more directly gain or produce assessable income will be found, in the ordinary case, in the use to which the borrowed funds are put".

Counsel also cited *Kidston Goldmines Ltd. v FC of T 91 ATC 4538.*

(g) The Appellants then submitted that money borrowed and interest on money borrowed to pay essential business debts are an allowable deduction under Section 33(1)(a) of the Act whether not the income had been produced at the time of settlement of the debt. Payment of debts are an essential part of any business.

(h) The first loan was raised to pay royalties which was an essential business expense of the Appellant. The second loan, a replacement loan, was taken in US dollars and not in Ringgit and the refinancing did not change the character of the loan.

(i) The Appellant also argued that the Special Commissioners had no right to enquire into the question of reasonableness and to say that the Appellants could have avoided borrowing by not making donations.

ARGUMENTS BY THE REVENUE

(j) It is the contention of the Respondent that:-

The second loan cannot be said to be employed in the production of income because it was not towards payment of royalties but to settle a debt already owing. The royalties had already been paid.

(b) The two loans were different in nature in respect of the payment; the recipient of the money borrowed under the first loan was the State Forestry Department, and the recipient of the money under the second loan was the bank.

(c) It was submitted by the Revenue that even if the Atherton test is applied, the interest arising from the second loan would still fail to qualify for deduction.

(d) It was also their contention that one must be careful when we refer to authorities of the other jurisdictions, due consideration must be given to the differences in the wordings between the provisions.

HELD

Appeal allowed with costs.

GROUNDS OF JUDGEMENT

During his submission, Counsel for the Respondents was asked by the Court this question: If the first loan had in fact been used for payment of royalties would the interest payment on the loan be deductible for income tax purposes? Counsel's answer is in the affirmative. In the light of the answer and the submission of Counsel's on both sides, we seem to have narrowed the whole case down to the purpose of the second loan. Was it a totally separate loan not connected directly or indirectly with the production of income? Or was it a relacement loan?

There is no dispute that the second loan was utilised to pay off the first loan so instead of paying interest on the fist loan, the Appellants paid interest on the second loan. The Sabah Development Bank allowed the second loan to be used to settle the first loan. According to Counsel for the Appellants the second loan was infact a replacement loan, the same as refinancing. Counsel says that the replacement loan was taken so that the liability could be in US dollars and not in ringgit but this did not change the character of the loan. I must confess I cannot quite follow the argument by Counsel for the Respondent that the two loans were different because the recipients of the money under the two loans were different. I do not think that the fact that Revenue was not informed of the purpose of the second loan and that the letter from the Bank did not specifically state that the approval of the second loan was for payment of royalties are significant considerations.

To my mind what is of real importance is that the second loan was fully used to pay off the first loan. In the circumstances and the undisputed facts in this case I agree with Counsel for the Appellants that the second loan should be considered as a replacement loan or refinancing. It follows, as a matter of logic and common sense that since interest payments on the first loan were deductible (conceded by Revenue) because they fall within the provision of section 33(1)(a) of the Act, interest payments on the second loan would also be deductible for income tax purposes.

For reasons given above I am of the view that the appeal should be allowed.

COUNSEL

WSW Davidson and Richard Barnes (with him) of Messr Shelley Yap Leong Tseu Chong Chia & Co. for the Appellants.
Mr. Kok Keng Fai for the Respondents.

PRESIDING JUDGE

Yang Arif Datuk Seri Panglima Charles N C Ho
Judge, Sabah & Sarawak

Service Tax On Management Fees

By Tax Bug

1. Introduction

Service Tax is to be levied on management fees from 1st of January 1998, as proposed in the budget of 1998.

2. The Law

"Companies, firms and sole proprietors providing management services, excluding companies, firms and sole proprietors providing management services and having an annual sales turnover of less than RM300,000 of prescribed services."

Prescribed services are defined to mean the provision of all types of management services including project management and project co-ordination.

3. Ordinary Meaning

Management services has not been defined and in the absence of a definition, the ordinary meaning of the word is used. Management services will include services rendered in respect of managing the operations of businesses (of another person, company, etc.) The following will have to be considered; What is -

- the **nature** of the function
- the **purpose** of the function
- explain the **structure** of the function
- explain the **process** of function

"Management - the action or manner of managing" (Shorter Oxford English Dictionary)

"Managing" - handle, conduct, carry out successfully, control the affairs, administration, direction, control, to take charge, administer, to deal with. (Shorter Oxford English Dictionary)

A "manager" is one who directs, control and secures the doing of things, a title given to the person in charge of a shop, branch of a bank, factory, or other establishment." [The Oxford Companion to Law (1980 edition)]

4. The Official View

The relevant authorities are of the view that the following will fall within the definition of management services:

Corporate Affairs Management
- co-ordination of group-wide strategic and business planning
- co-ordination of group-wide management policies
- monitoring of group-wide performance and co-ordination
- mergers and acquisitions
- privatisation proposal/studies
- feasibility studies

Human Resource Management
- management/organisation studies
- compensation structures
- group key manpower planning and control
- recruitment of key/senior management staff
- training planning and administration
- group manpower development and planning (at group planning centre)

Internal Audit
- financial audit
- management audit
- EDP audit
- special investigations

Management Information Systems
- group management information services
- support in EDP system development and implementation
- office automation

Administration/Secretarial
- secretarial services cover services provided by company secretaries, accountants, lawyers, etc.
- accounting
- laison with government/other agencies
- filing of statutory forms and returns
- maintain and updating of statutory records
- preparation of agenda and issue notice of statutory meeting, and board resolutions
- attending to share registration

Sales & Marketing Management
- formulation of marketing plans/strategies
- planning/co-ordination of promotion materials
- set up sales offices
- co-ordination with lawyers on sale & purchase agreement
- assist in billing as well as debt collection

Property Management
- high-rise building/condominiums
- business centre/shopping complexes
- stadium/sport/exhibition complexes

Financial Management
- prepare and management of accounting system and reports
- tax administration
- budgetary controls
- prepare payments, banking documents and management of cash flow
- monitoring utilisation of banking facilities

Asset Management
- receivers
- liquidators
- trustees, managers of deceased estates

Preliminary Development Services
- feasibility study/investigation and research
- recommendation/proposal
- preparation of agreement

Project Managment Services
- management facilities -appointment of staff/ consultants and secondment of staff
- project planning and control
- project implementation and administration
- co-ordination with relevant authorities - for approvals, certificates, etc.
- supervision
- regular report on work progress

Construction Management Services
- establish tendering procedures
- call for submission of tender quotations
- co-ordination with relevant authorities for inspection of sites, etc.
- overall administration Of progress and collection of contract works
- monitor costing and site expenses
- control and supervision at site

5. Service tax is not applicable to the following:

   - provision of management services to overseas countries, Labuan, Langkawi and free zones under the Free Zones Act 1990.
   - reimbursement of rental and other non management expenses sharing
   - provision of management services to different divisions within the same company

6. Reimbursement of Management Cost

   Service tax a applicable to intra group charges, which recovers the cost of providing common management team to service the subsidiaries in the group. However the reimbursement of rental and other expenses is not subject to service tax.

   Where a special purpose company is set up for the convenience of employment law purpose to employ all employees but the cost of employee is charged to the respective companies which receive the management services, there is service tax.

   Expenses incurred in providing management services, which are not charged out to the subsidiaries will also suffer service tax, if management decides not to raise a bill or charge the management expense out.

   There will be no service tax on the recovery of expenses incurred in respect of office rental, electricity and other expenses of the management centre.

7. Licensed Manufacturing Warehouse

   The provision of management service to Licensed Manufacturing Warehouse is subject to service tax.

WORKING TOGETHER WITH THE INLAND REVENUE BOARD

By
Low Choi Kam
Technical Manager
Malaysian Institute of Accountants

Since the corporatization of the Inland Revenue Board (IRB) there has been a greater openness on the part of the tax authorities for consultative discussions with tax agents and other tax practitioners. Following a recent dialogue with the IRB, the Board has requested the Malaysian Institute of Taxation and the Malaysian Institute of Accountants to convey the following messages to their members, with the objective of seeking greater public-private sector cooperation in order to overcome specific administrative problems encountered by the tax authorities. The MIT and MIA are pleased to play this role in helping to forge closer cooperation and more open channels of communication between the IRB and tax practitioners. The issues highlighted by the IRB are summarised below:-

■ **Remitting Standard Tax Deduction payments to the IRB on time**

Presently deductions from employee's pay made under the STD scheme is required to be remitted to the Collections Branch of the IRB on or before the 10th of each month. However, there are instances of employers who are late in remitting tax deducted to the IRB and tax agents are requested to impress upon their clients the need to comply with the time limit for remitting tax to the IRB.

In this connection, the MIT would like to highlight a report in a local newspaper[1], which reported that the IRB had issued a stern warning that employers who fail to remit their workers' tax deductions will be slapped with the maximum penalty of RM1,000 per employee for each unremitted month. The penalty is imposed under Rule 17 of the Income Tax (Deduction From Remuneration) Rules 1994.

■ **Information on CP 39**

Employers should ensure that all information concerning employees in the CP39 are correct and consistent from month to month. For example, if the employee's name is Tan Ah Wah, the same name should be used every month and not the full name in some months, and some abbreviated form such as A.W. Tan in others.

■ **Renewal of tax agent's licence**

The IRB has recently launched the Code of Ethics For Tax Agents, and would like to reinforce the following messages for tax agents:-

- The IRB has encountered situations in which tax agents seeking to renew their licences have been found to fall foul of the expectation set out in paragraph 5.3 in the Code, that the tax agent's own tax affairs should be kept up-to-date, and tax payable be settled within the time allowed. While not wishing to create more formal regulations relating to the renewal of licences by tax agents, the IRB wishes to emphasize that the above expectation is not a mere option but a condition for the renewal of a licence.

- Paragraph 4.1.5 of the Tax Agent's Code of Ethics reads,

  "He shall not enter into any arrangement with an unqualified person to endorse the work of that unqualified person."

There have been complaints to the IRB about the breach of this particular code of conduct by certain tax agents. Again, it is emphasized that the IRB views this breach as a very serious one and will not hesitate to ensure that offenders suffer the full adverse consequence of the breach.

Members of MIT are reminded to

[1] The Star, September 2, 1997

familiarize themselves with the Institute's Rules and Regulations (On Professional Conduct and Ethics). Members who fail to observe the standards set therein may be required to answer a complaint before the Investigation and Disciplinary Committees.

Tax computation for companies

The Companies Branch in Kuala Lumpur has raised the following points in which tax agents' cooperation is required to facilitate the work of processing returns by assessors:

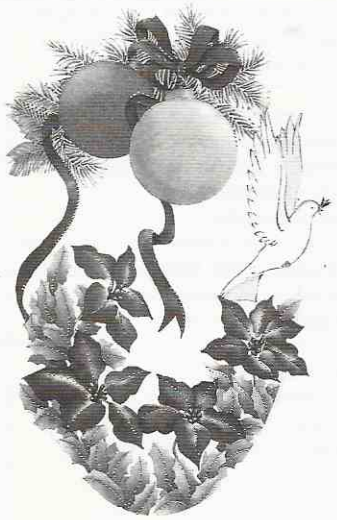
- A tax computation should be as complete as possible. Any error, whether it is to the advantage of the taxpayer or not should be voluntarily disclosed to the IRB. For example, the tax agent should inform the assessor about any expense that has been overclaimed (in the same way that they will usually write to the IRB to make an additional claim for expenses that have not been claimed in full for some reason or other.)

- There are instances where tax agents send reminders to the IRB to finalize a case every two weeks or so, after a return for a client are submitted. The Head of the Companies Branch in Kuala Lumpur would like to assure tax payers and their agents that the Branch has a programme of work that ensures that all return forms submitted are processed in a timely manner, and there is no necessity to send frequent reminders in respect of any current year case. Tax agents are also requested to ensure that the process of finalizing returns is not disrupted by ensuring that all documents such as donation receipts and dividend vouchers are enclosed together with the return.

QUOTE

Our knowledge is the amassed thought and experience of innumerable minds

Ralph Waldo Emerson



Merry Christmas And
A Happy New Year

From
The Council Of The
Malaysian Institute of Taxation

INCOME TAX ACT 1967
INCOME TAX (EXEMPTION / AMENDMENT / DOUBLE TAXATION AGREEMENT) ORDERS 1997
(Income Tax Orders, Amendments and Treaties for the months of January to June 1997)

NO	TITLE	REFER P.U (A)	DATE OF GAZETTE NOTIFICATION	SUBJECT	EFFECTIVE DATE/REMAR
1	Income Tax (Returns By Employers) Order 1997	1	2/1/97	Employer to Prepare And Deliver Return	From the date of publication of this order in the Gaze
2	Income Tax (Deduction From Remuneration) (Amendment) Rules 1997	13	16/1//97	Amendment to Schedule of Monthly Tax Deduction P. U.(A) 507/94	1997
3	Income Tax (Exemption) Order 1997	15	23/1/97	Tax exemption for the following artistes who are in Malaysia in connection with the "Marimba - Imai Tadako" performance held at the Panggung Eksperimen, Kompleks Budaya Negara, Kuala Lumpur on 13/9/96 **Name** — **International Passport No.** 1. Tadako Imai — MN3709534 2. Tatsushi Otaka — MM3252390 3. Yuichi Ise — MM4904798 4. Tomoko Uemura — MP4071359	
4	Income Tax (Exemption)(No.2) Order 1997	29	30/1/97	Tax exemption up to 65% in respect of income for the provision of **'qualifying professional services'** rendered in Labuan by that person or his employee to an Offshore Company. **'Qaualifying professional service'** means legal, accounting financial or secretarial service and includes the services provided by a "trust company" as defined in the Labuan Trust Companies Act 1990.	Y/A 1997 to Y/A 20
5	Income Tax (Exemption)(No.3) Order 1997	43	6/2/97	Tax exemption for sixteen (16) foreign artistes who are in M'sia for the "Persembahan Kesenian Kumpulan Budaya Melayu Afrika Selatan di Malaysia" from 3 to 15/7/96.	
6	Income Tax (Exemption)(No.4) Order 1997)	44	2/6/97	Tax exemption for ten (10) foreign artistes who are in M'sia in connection with their performance at the "Konsert Orkestra Simfoni Kebangsaan " held at the Panggung Eksperimen, Kompleks Budaya Negara on 27/7/96.	
7	Income Tax (Exemption)(No.5) Order 1997	45	6/2/97	All income of the Kuala Lumpur Options and Financial Futures Exchange Berhad (excluding dividend income) are exempt from tax.	Y/A 1997 to Y/A 200
8	Income Tax (Exemption)(No.6) Order 1997	46	2/6/97	All income of the Malaysia Airports Bhd (excluding dividend income) are exempt from tax.	Y/A 1997 to Y/A 199
9	Income Tax (Exemption)(No.7) Order 1997	80	27/2/96	Tax exemption up to an amount equivalent to 50% of all income of the Bintulu Development Authority (excluding dividend income).	Y/A 1997 to Y/A 200

INCOME TAX ACT 1967
INCOME TAX (EXEMPTION / AMENDMENT / DOUBLE TAXATION AGREEMENT) ORDERS 1997
(Income Tax Orders, Amendments and Treaties for the months of January to June 1997)

NO	TITLE	REFER P.U (A)	DATE OF GAZETTE NOTIFICATION	SUBJECT	EFFECTIVE DATE/REMARKS
	Income Tax (Exemption)(No.8) Order 1997	81	27/2/96	All income of the Kuaia Lumpur Tin Market (excluding dividend income) are exempt from tax.	Y/A 1997 to Y/A 2001
	Income Tax (Exemption)(No.9) Order 1997	82	27/2/96	Tax exemption up to an amount equivalent to 70% of all income of Sabah Sports and council (excluding dividend income).	Y/A 1997 to Y/A 2001
	Income Tax (Exemption)(No.10) Order 1997	83	27/2/96	Tax exemption up to an amount equivalent to 70% of all income of Merdeka Stadium Corporation (excluding dividend income).	Y/A 1997 to Y/A 2001
	Income Tax (Exemption)(No.11) Order 1997	114	3/20197	Tax exemption for the foreign consultants from King's College London who are in Malaysia solely for the rendering of consultancy services in connection with the establishments of Pusat Kawalan Doping in the Universiti Sains Malaysia.	
	Income Tax (Exemption)(No.12) Order 1997	122	3/27/97	Tax exemption for one hundred and ten (110) artistes who are in Malaysia for the purpose of performing in the "Konsert Orkestra Remaja Asia" at the Shangri-La Hotel Kuala Lumpur on 21/8/96.	
	Income Tax (Exemption) (No.13) Order 199	153	4/17/97	Tax exemption up to an amount equivalent to 50% of all income of Federal Land Development Authority (exduding dividend income).	Y/A 1997 to Y/A 2001
	Income Tax (Exemption)(No.14) Order 1997	154	4/17/97	Tax exemption up to an amount equivalent to 70% of its statutory income of Perbadanan Pembangunan Bandar (excluding dividend income).	Y/A 1997
	Income Tax (Exemption)(No.5) Order 1997	163	24/4/97	All income of the State Museum Boards are listed below (excluding dividend income) are exempt for tax. The exemption given shall not include exemption from the payment of development tax in respect of development income under the provisions of the Supplementary Income Tax Act 1967. **Name of State Museum Boards** 1. Lembaga Muzium Negeri Terengganu 2. Lembaga Muzium Negeri Pulau Pinang 3. Lembaga Muzium Melaka 4. Malacca Museums Corporation 5. Selangor Museum Board 6. Yayasan Warisan Negeri Johor 7. Lembaga Muzium Negeri Kedah 8. Lembaga Muzium Negeri Pahang 9. Negeri Sembilan Museum Board 10. Kelantan State Museum Corporation 11. Lembaga Muzium Negeri Perak	**Exemption period (Y/A)** 1978 - 2001 1974- 2001 1985-1993 1994-2001 1990- 2001 1989 -2001 1975 -2001 1976-2001 1993 -2001 1977-2001 1988 -2001

Income Tax Ruling ITR 1997/2

VALUATION OF BENEFITS-IN-KIND (BIK)

Date of Issue - 25 August 1997

PREAMBLE

The gains or profits from an employment chargeable under Section 13 of the Income Tax Act, 1967 have been defined to include the value of any Benefits-in-Kind (BIK) provided for the use or enjoyment by the employee. As such, employers are required to declare the value of BIK that the employers have borne in respect of the services of an employee in the Form CP8A annually.

In 1997, the Inland Revenue Board reviewed the **1987 Guidelines for Valuation of BIK Provided to Employees** taking into consideration the increased costs of providing the benefits and the new BIK applicable.

RULING

Beginning from the **Year of Assessment 1998** the following valuation of BIK are to be applied.

MOTORCARS AND RELATED BENEFITS

- **Motorcars And Fuel Provided**

COST OF CAR WHEN NEW (RM)	ANNUAL VALUE OF BIK (RM)	FUEL PER ANNUM (RM)
Up to 50,000	1,200	600
50,001 - 75,000	2,400	900
75,001 - 100,000	3,600	1,200
100,001 - 150,000	5,000	1,500
150,001 - 200,000	7,000	1,800
200,001 - 250,000	9,000	2,100
250,001 - 350,000	15,000	2,400
350,001 - 500,000	21,250	2,700
500,001 and above	25,000	3,000

- **Fuel Provided Without Motorcar**
  The actual value of fuel provided is treated as benefit received.

- **Driver Provided**
  The value of the benefit is fixed at RM3,600.

HOUSEHOLD FURNISHINGS, APPARATUS & APPLIANCES

TYPES OF BIK	ANNUAL VALUE OF BIK
1. Semi-furnished with furniture in the lounge, dining room, or bedrooms	RM840 (RM70 per month)
2. Semi-furnished with furniture as in 1 above and one or more of the following:- air-conditioners curtains carpets	RM1,680 (RM140 per month)
3. Fully-furnished with benefits as in 1 dan 2 above plus one or more of kitchen equipment, crockery, utensils and appliances.	RM3,360 (RM280 per month)
4. Service charges and other bills such as for water, electricity and telephone.	Service charges and bills paid by the employer.

OTHER BENEFITS

TYPES OF BIK	ANNUAL VALUE OF BIK
Mobile telephone (rental & charges)	RM600
Gardeners	RM3,600
Domestic servants	RM4,800
(i) Interest free loan (ii) Subsidised loan/interest below the market value rate	(i) Value of interest paid by employer (ii) Subsidised loan interest paid by employer
Insurance premium	Annual insurance premium paid by employer
School/tuition fees	Actual school/tuition fees paid by employer
Membership in recreation clubs	Membership fees paid by employer

TAX EXEMPT BENEFITS

- Goods and services offered at a lower price or at a discount
- Food and drinks provided/subsidised
- Free transport
- Child care facilities
- Medical/Dental benefits
- Leave passages:-
  - Within Malaysia not exceeding three times in any calendar year.
  - Outside Malaysia not exceeding one passage in any calendar year.

OTHER BENEFITS NOT LISTED

Value of benefits may be made by reference to the formula:-

$$\frac{\text{Cost of the asset providing benefit/amenity}}{\text{Prescribed average life span of asset}}$$

The Inland Revenue Board of Malaysia reserves the right to amend any part of this Ruling or repeal the whole Ruling without giving any reason thereof.

This Ruling does not deprive tax payers of the right of appeal to the Special Commissioners of Income Tax.

GUIDELINES FOR VALUATION OF BENEFITS-IN-KIND (BIK) PROVIDED TO EMPLOYEES

Introduction

These guidelines serve to give further clarification on the Income Tax Ruling ITR 1997/2 for valuation of benefits-in-kind.

This Circular is to be read together with the ITR 1997/2.

Background

A review had been taken on the earlier guidelines on BIK which were issued on 10.4.1987. The revised values of the BIK have been determined after taking into consideration the inflation rate over the past ten years and the substantial price increase of cars, ranging from 18% to 125% and the new BIKs enjoyed by the employees. Various inputs have also been obtained from discussion with the Federation of Malaysian Employers (MEF) and the Malayan Agricultural Producers Association (MAPA).

The formula for the valuation of annual BIK and the prescribed average life span of the various assets have not been changed (See Appendix I)

Motorcars And Related Benefits

MOTORCARS AND FUEL PROVIDED

- The value of the benefits for the private use of car and fuel provided will be based on the following table:-

COST OF CAR WHEN NEW (RM)	ANNUAL VALUE OF BIK (RM)	FUEL PER ANNUM (RM)
Up to 50,000	1,200	600
50,001 - 75,000	2,400	900
75,001 - 100,000	3,600	1,200
100,001 - 150,000	5,000	1,500
150,001 - 200,000	7,000	1,800
200,001 - 250,000	9,000	2,100
250,001 - 350,000	15000	2,400
350,001 - 500,000	21,250	2,700
500,001 and above	25,000	3,000

Cost here refers to the actual cost or market value of the car (rented/leased) including accessories but excluding financial charges, insurance premiums and road tax.

Toll charges borne by the employers are deemed to be included in the value of BIK assessed for cars.

- The value of the car benefit equivalent to **half of the above rates** is taken if the car provided is **more than five years old** but the value of fuel provided will remain unchanged.

- The value of the benefit should be adjusted appropriately if the car is not provided throughout the basis year.

- Employers should in all cases indicate in the individual employee's statement of remuneration the type, year, model and date the car is provided to the employee.

- Employers should report the car and fuel benefits provided to the employees based on the above table. If an employee disputes the value as being excessive, he should take up the matter with the Assessment Branch concerned when submitting his Return. To substantiate the claim for business use detailed and adequate records must be submitted by him.

FUEL PROVIDED WITHOUT MOTORCAR

The benefit to be assessed is equivalent to the actual value of fuel provided.

DRIVER PROVIDED

Where a driver is provided, the value of the benefit is fixed at RM300/- per month.

Household Furnishings, Apparatus & Appliances

To avoid detailed calculations by employers and for ease of application of the ITR 1997/2 the following figures are to be adopted:-

TYPES OF BIK	ANNUAL VALUE OF BIK
1. Semi-furnished with furniture in the lounge, dining room, or bedrooms	RM840 (RM70 per month)
2. Semi-furnished with furniture as in 1 above and one or more of the following:- air-conditioners curtains carpets	RM1,680 (RM140 per month)
3. Fully-furnished with benefits as in 1 and 2 above plus one or more of kitchen equipment, crockery, utensils and appliances.	RM3,360 (RM280 per month)
4. Service charges and other bills such as for water, electricity and telephone.	Service charges and bills paid by the employer.

The values may be adjusted by reference to whether any or all of the above categories of furnishings are provided. Thus an employee provided with all the stated furnishings except those in category 1 will be assessed on the value of BIK of RM2,520 (RM3,360 - RM840).

These values may also be adjusted suitably by reference to the period provided. Where an employee is provided with the furnishings in category 1 with effect from 1.4.1997, then the value of BIK assessed for assessment year 1998 will be for the period 1.4.1997 - 31.12.1997 amounting to PM630 (9 x RM70).

Appropriate adjustment on the value of BIK may be made, if the furnishings / apparatus / appliances are shared with other employee.

Where it is felt that the above values are excessive, the valuation by the employer of the benefit provided may be made by reference to the stated formula on an item-by-item basis.

Fans and water heaters are disregarded as they are treated as forming part of the residential premises.

Other assets provided to employees for entertainment, recreation or other purposes such as piano, organ, television, stereo set, swimming pool (detachable) etc. would constitute additional benefits and should be separately valued based on the formula.

Other Benefits and Tax Exempt Benefit

These benefits are clearly spelt out in paragraphs under **Other Benefits** and **Tax Exempt Benefits** of the ITR 1997/2.

With reference to Insurance premium under the paragra **Other Benefits** the ITR 1997/2, the premiums excluded a as follows:

- Premiums which are obligatory for foreign workers i lieu of contributions to SOCSO.
- Group Policy Insurance premiums for workers in ca of accident/injury.

Other Benefits Not Listed

If there are other facilities or benefits provided to t employees, the amounts so provided should be report by the employer based on the formula.

Any claim for deductions in respect of official use of a BIK must be taken up and substantiated by the employ in submitting his Return.

Certification

In cases where the reporting of the employees' income not made in E Return, the employer is required to make separate certification regarding the reporting of values o BIK. The following format should be adopted;

CERTIFICATION

I.....(NRIC No. .....)
being .....hereby certify that in
(Designation)
reporting the values of benefits-in-kind provided to employees, I have duly adhered to the guidelines issued by the Director General of Inland Revenue, Malaysia, and the information and values reported are true and complete to the best of my knowledge.

Date: .....

.....
Signature of Employer

Where the reporting of the employees' income is made in the E Return, the above certification is not necessary as it has duly been incorporated in the E Return.

APPENDIX I

Generally, the annual value of a given benefits-in-kind provided is computed by reference to the following **formula**:-

$$\frac{\text{Cost of the asset providing benefit/amenity}}{\text{Prescribed average life span of asset}} = \text{annual value of benefit}$$

Cost means the actual cost incurred by the employer or market value of the asset. Thus, in the case of an asset costing RM10,000 and having a life span of 10 years the annual value would be RM1,000.

The prescribed life span of the various assets is as follows:-

ASSET	PRESCRIBED AVERAGE LIFE SPAN (YEARS)
Motorcar	8
Furniture and Fittings:-	
Curtains, carpets	5
Furniture, sewing machine,	15
Air-conditioner	8
Refrigerator	10
Kitchen Equipment (i.e. crockery, rice cooker, electric kettle, toaster, coffee-maker, gas cooker, cooker hood, oven, dish-washer, washing machine, dryer, food processor etc.)	6
Entertainment and Recreation:-	
Piano	20
Organ	10
Colour television, video player, stereo set	7
Swimming pool (detachable), sauna	15
Miscellaneous:-	
Mobile telephone	15

LEGISLATION

INCOME TAX ACT 1967
INCOME TAX (EXEMPTION) (No. 48) ORDER 1997

Act 53

In exercise of the powers conferred by paragraph 154(1)(b) of the Income Tax Act 1967, the Minister makes the following rules:

Citation and commencement.

1. (1) These rules may be cited as the **Income Tax (Qualifying Plant Allowances) (No.2) Rules 1997**.

(2) These Rules shall have effect in respect of qualifying plant expenditure incurred on or after 17 October 1997.

Initial allowance.

2. Subject to subrule 1(2), initial allowances under paragraph 10 of Schedule 3 to the Act on qualifying plant expenditure in respect of imported heavy machinery as set out in the Schedule to these Rules, shall be calculated at a rate of 10 percent on the qualifying plant expenditure.

Annual allowance.

3. Subject to subrule 1(2), annual allowances under paragraph 15 of Schedule 3 to the Act on qualifying plant expenditure in respect of imported heavy machinery as set out in the Schedule to these Rules, shall be calculated at a rate of 10 percent on the qualifying plant expenditure.

SCHEDULE

1. Building and Construction Industry-

Earth-moving plant and heavy equipment-bulldozers, ditchers, excavators, graders, loaders, rippers, rollers, rooters, scrapers, shovels, tractors.

2. Mining Industry-

Earth-moving plant and heavy equipment.

3. Plantation Industry-

Earth-moving plant and heavy equipment

4. Timber Industry-

Heavy equipment-bulldozers, tractor engines, tractors and timber haulage vehicles.

Made 31 October 1997.
[Perb. CR (8.09) 294/6/4-9 (SJ. 5) Vol. 2; PN. (PU2) 80/XXV;LHDN. 01/35/(S)/42/51/60-2.

ANWAR IBRAHIM,
Minister of Finance

(To be laid before the Dewan Rakyat pursuant to subsection 154(2) of the Income Tax Act 1967.)

Summary of Tax Incentives

INCENTIVES UNDER-THE PROMOTION OF INVESTMENTS ACT, 1986 ("PIA")

Pioneer Status ("PS")

Criteria for Eligibility

The following criteria must be satisfied for an applicant to be eligible for PS :

- Any company participating in a promoted activity or producing a promoted product *(PIA -S. 5)*.

(Note: In an application for PS in respect of a promoted activity or promoted product in relation to agriculture, "company" includes a sole proprietorship, partnership and association solely engaged in agriculture) *(PIA - S. 13)*

The general features of PS incentive include (effective for applications received after 1 November 1991):

- 70% of statutory income ("S.I.") exempt from tax. *(PIA - S. 21B)*
- Balance of 30% is taxed at the normal corporate tax rate.
- No carry forward of unabsorbed CA to the post-pioneer period. *(PIA - S. 18)*
- No carry forward of unabsorbed losses to the post-pioneer period.
- Tax relief for 5 years from production day. *(PIA - S. 14)*
- Exempt income is credited to an exempt account from which exempt dividend may be distributed.

The following specific features of PS incentive are also available:

- 85% of S.I. exempt from tax for projects located in promoted areas.
- 100% exemption of S.I. for projects of national and strategic importance. Application may be made for extension of the tax relief period in respect of such projects for a further 5 year. *(PIA -S14A)*
- 100% exemption of S.I. is also granted for the following:
  - high technology companies;
  - companies participating in a promoted activity or producing a promoted product in an industrial linkage programme *(from YA 1997)*;
  - contract Research & Development companies which provide R & D services in Malaysia only to companies other than related companies.

PS is also available to small scale manufacturing companies ("SMI") incorporated and resident in Malaysia with at least 70% of its equity held by Malaysians. *(PIA - S. 6(1A) (1B) wef 1990)*

Summary Of Tax Incentives

In line with the Institute's objective to provide technical services to members, this Summary is prepared for circulation. Its purpose is to serve as a handy reference summarising the salient features of the major tax incentives available and is not meant to be exhaustive. The scope of this document does not include the following incentives:

- *Abolished incentives such as Abatement of Statutory Income for Exports (abolished 1 January 1994) and Export Allowance (abolished 1 January 1994).*
- *Other non-tax incentives*
- *Incentives for specific industries such as Fund Management, Unit Trust, Banking, Insurance, Venture Capital, Operational Headquarters and Shipping.*
- *Incentives for International Offshore Financial Centre (Labuan).*

You are advised to refer to the relevant sections of the legislation for more details.

(Note: An SMI is a company whose shareholders' funds as at the date of the granting of the PS and issue of the Pioneer Certificate do not exceed RM500,000)

The SMI must comply with one of the following criteria to be eligible for PS:

- The SMI must not be a subsidiary of another company with total shareholders' funds of more than RM500,00;
- The SMI produces components or inputs for supply to the manufacturing industry;
- The SMI's products are substituting imports and the local content of the material used is more than 50% in terms of value;
- The SMI exports 50% or more of the total production including sales to companies located in the Free Zones or Licensed Manufacturing Warehouses; and
- The project undertaken by the SMI contributes towards the social-economic development of the rural population.

INVESTMENT TAX ALLOWANCE ("ITA")

Criteria for Eligibility

The following criteria must be satisfied for an applicant to be eligible for ITA:-

- Any company participating in a promoted activity or producing a promoted product. *(PIA -S. 26)*

(Note: Where an application is for a project which is related to agriculture, "company" includes a sole proprietorship, partnership and association solely engaged in agriculture). *(PIA - S. 31)*

The general features of ITA incentive include (effective for applications received after 1 November 1991) *(PIA - S. 29A)*:

- Deduction of ITA at 60% of the qualifying capital expenditure ("QCE") against S.I., subject to a maximum of 70% of the S.I. The balance of 30% is taxed at the normal corporate tax rate.
- Unabsorbed ITA is carried forward until fully utilised.
- Amount of ITA utilised is credited to tax exempt account from which tax exempt dividends may be declared.
- QCE must be incurred within 5 years from the approval date.

The following specific features of ITA incentive are also available:

- ITA at 100% of QCE against 100% of S.I. for projects of national and strategic importance. Tax relief is granted for 5 years. *(wef 1-11-91)*
- ITA at 80% of QCE against 85% of S.I. for projects located in the promoted area. Tax relief is granted for 5 years. *(wef 29-10-93)*
- ITA at 60% of QCE against 100% of S.I. for high technology company, *(wef 20-10-94)* or for a company participating in a promoted activity or producing a promoted product in an industrial linkage programme. Tax relief is granted for 5 years.
- ITA at 100% of QCE for 10 years against 70% of S.I. for company which establishes technical or vocational training institutes in Malaysia.
- ITA at 100% of QCE for 10 years against 70% of S.I. for contract R&D or R&D company. *(wef 29-10-93)*
- ITA at 50% of QCE for 10 years against 70% of S.I. for in-house R&D project. *(wef 29-l 9-93)*

PS and ITA are mutually exclusive, i.e. pioneer companies are not eligible for ITA except where the the tax holiday has expired or pioneer status has been withdrawn.

QCE is capital expenditure incurred on *(PIA - S. 29(7))*:

Manufacturing;

- a factory or plant and machinery used in Malaysia for the purposes of the promoted activity or promoted products.

Agriculture

- clearing and preparation of land;
- planting of crops;
- irrigation or drainage systems;
- plant and machinery used in an agricultural or pastoral business including crop cultivation, animal farming, aqua culture or inland fishing;
- construction of access roads and bridges; and
- construction or purchase of buildings including those used for welfare and accommodation.

Hotel

- construction of hotel building;
- alteration, extension and renovation of the building;
- plant and machinery; and
- other facilities of hotel business.

Pioneer status or ITA for projects in the tourism sector:

The following projects in the tourism sector also qualify for PS or ITA incentives:-

- Expansion of existing hotels or construction of budget hotels (up to 3 star category as certified by the ministry of Culture, Arts and Tourism). This is effective only in respect of projects which have not commenced operation on 25 October 1996.
- Construction of holiday camps and recreational projects (effective for applications received after 25 October 1996).
- Construction of convention centres (with hall capable of accommodating 3000 participants).

Applications for PS or ITA

- Applications should be made to the Malaysian Industrial Development Authority (MIDA) on the same forms as those used in applying for a manufacturing licence under the Industrial Coordination Act 1975. The forms used are

Form	Type
ICA(1)	Firm or person intending to engage in new manufacturing project
1CA(1)	Existing manufacturer (formerly exempted) applying for manufacturing licence.
ICA(3)	Licenced manufacturer applying for expansion or for the manufacture of additional products.
ICA(4)	Firm or person intending to undertake new agricultural activity/integrated agricultural project
ICA(5)	Existing agricultural project/integrated agricultural project applying for expansion or for diversification
ICA(6)	Application for duplicate licence

- 5 copies of the completed forms are to be submitted to:-

  The Chairman
  Malaysian Industrial Development Authority,
  3rd - 6th Floor, Wisma Damansara,
  P.O. Box 10618,
  Jalan Semantan, 50720 Kuala Lumpur

- For projects located in Sabah and Sarawak, in addition to the 5 copies sent to the KL office, 2 copies should be sent to the MIDA offices in Sabah and Sarawak respectively.

Projects in	Sabah	Sarawak
2 copies of forms to be sent to	The Regional Director, Malaysian Industrial Development Authority Sabah, 4th Floor, Bank Negara Building, P.O. Box 11915, 88730 Kota Kinabalu, Sabah	The Regional Director, Malaysian Industrial Development Authority Sarawak, 4th Floor, Room 404, Bank Negara Building, 147, Jalan Satok, P.O. Box 716, 9314 Kuching, Sarawak

- Application for PS for small scale manufacturing companies should be made on Form lKS-1/89. 5 copies of the application form together with supporting documents should be submitted to MIDA at the address given above.

Industrial Adjustment Allowance ("IAA")

Criteria for Eligibility

The following criteria must be satisfied to be eligible for IAA:

- Any company participating in industrial adjustment and not enjoying PS or lTA. *(PIA -S. 3lA)*
- lndustrial adjustment refers to any approved activity proposed to be undertaken by a particular sector in the manufacturing industry to restructure by way of reorganization, reconstruction or amalgamation with a view to:
  - strengthening the basis for industrial self-sufficiency;
  - improving industrial technology;
  - increasing productivity,
  - enhancing the efficient use of natural resources; and
  - efficient management of manpower.

The following are subsectors for which approval may be granted for industrial adjustment programmes: -

- Bar and rod rolling
- Veneer and plywood sawmilling
- Textiles
- Motor car assembly
- Oil palm refining and factionation
- shipbuilding

The features of IAA incentive are:-

- IAA for up to 100% of QCE is given as a deduction against adjusted income ("AI") after abatement of all other AI incentives.
- Unabsorbed losses and CA can be carried forward to subsequent years;
- Unabsorbed IAA is carried forward until fully utilised.
- Amount of IAA utilised is credited to tax exempt account from which tax exempt dividends can be declared.

QCE must be incurred within 5 years from the date the approval is to take effect. *(PIA - S. 31E)*

QCE is capital expenditure incurred on:-

- factory;
- plant and machinery used for the purposes of the manufactured product.

QCE excludes capital expenditure incurred in buildings used as living accommodation, or plant and machinery used by a director, or a member of the management, administrative or clerical staff. *(PIA - S. 3IE)*

Application for IAA is made on the Form IAA 1/91. 5 copies of the completed forms should be submitted to MIDA in Kuala Lumpur at the address given under paragraph on Applications for PS or ITA.

Infrastructure Allowance

Criteria for Eligibility

The following criteria must be satisfied to be eligible for the Infrastructure Allowance:-

- Any resident company which has incurred capital expenditure on infrastructure in respect of a business operation in a promoted area. *(PIA - S. 41B)*

The features of the Infrastructure Allowance are:-

- S.I. equal to 100% of QCE is exempt from tax subject to a maximum of 85% of S.I.
- Unabsorbed losses can be carried forward to subsequent years;
- Unabsorbed allowance is carried forward until fully utilised.
- Amount of S.I. exempt from tax is credited to tax exempt account from which tax exempt dividends can be declared.

Infrastructure means any construction, reconstruction, extension or improvement of any permanent structure including a bridge, jetty, port or road in respect of a business operation in a promoted area. *(PIA - S. 41A)*

QCE must be incurred within 5 years from 29 October 1993. *(PIA - S. 41B)*

QCE excludes expenditure that qualifies for allowance given under the following. *(PIA - S. 41B)*

- Schedule 3 or 7A (Reinvestment Allowance) of the income Tax Act 1967
- IAA
- ITA
- plant or machinery used for storage, treatment or disposal of scheduled wastes.
- buildings used as living accommodation, or plant and machinery for use of members of the management, administration or clerical staff.

Claims for infrastructure allowance should be made in the annual return and tax computation submitted to the lRB.

INCENTIVES UNDER THE INCOME TAX ACT, 1967

Reinvestment Allowance ("RA")

Criteria for eligibility (Schedule 7A of the Income Tax Act, 1967 *("ACT")*:-

The following criteria must be satisfied for a company to be eligible for RA :

- The company must be resident in Malaysia;
- It has incurred capital expenditure on a factory, plant or machinery for a qualifying project in Malaysia , or
- It has incurred capital expenditure on an agricultural project for purposes of a qualifying project.

A "qualifying project" means a project for manufacturing or processing, undertaken for the purpose of expansion or modernisation of an existing business in respect of a product or related products, or diversification into a related product within the same industry.

With effect from the YA 1997, the meaning of the word "company" has been extended to include the following: -

- a agro-based co-operative society
- An Area, National or State Farmers' Association
- An Area, National or State Fishermen's Association

The general features of RA incentive include *(wef YA 1997)*:-

- RA at 60% of QCE against S.I. subject to a maximum of 70% of S.I. The balance of 30% of S.I is taxed at the normal corporate tax rate.
- Unabsorbed RA is carried forward until fully utilised.
- Amount of RA utilised is credited to tax exempt account for franking tax exempt dividends.
- Companies, which have been granted pioneer status, investment tax allowance, or industrial adjustment allowance, are not eligible for RA.
- Previous RA rates :

	Rate	For QCE incurred
Up to YA 1988	25%	
From YA 89	40%	before 1.1.94
	50%	from 1.1. 94
for small scale companies only	50%	

The following specific features of RA incentive are also available:-

- RA of 60% of QCE against 100% of S.I. for qualifying projects located in Sabah, Sarawak and the Eastern Corridor of Peninsula Malaysia;
- It has been announced in the 1997 Budget that wef YA 1998, companies that reinvest in equipment that significantly improve productivity are also eligible for RA of 60% of QCE against 100% of S.I.

Application for RA

A company claiming RA should submit the relevant particulars to the IRB by completing 2 copies of form EPS(PP/1/1997).

- The original is to be submitted to:-

  The Senior Assistant Director
  Inland Revenue Board
  (Address of Branch where the company submits its annual return.)

- 1 copy to be submitted to:-

  Director General of Inland Revenue
  Inland Revenue Board
  Technical Division,
  Block 11, 15th Floor Government Offices Complex,
  Jalan Duta,
  50600 Kuala Lumpur

(A) INVESTMENT ALLOWANCE ("IA")

Criteria for eligibility

The following criteria must be satisfied for an applicant to be eligible for IA (Schedule 7B of the ACT):-

- Resident companies in the communication, utilities and transportation services sub-sectors which have incurred capital expenditure in undertaking approved service projects ("ASP").

An "approved service project" means a project in the service sector in relation to transportation, communications utilities or any other sub-sector approved by the Minister of Finance. Approval for the incentive is granted after consideration of the following criteria:-

- Large capital investment and long gestation period;
- Import substitution and export and foreign exchange earning potential;
- Utilization and transfer of advanced technology;
- Generation of employment opportunities and utilization of expertise;
- Imposition of tariffs controlled by government;
- Contribution towards efficiency of other sectors of the economy;

The general features of IA incentive include *(wef YA 1996)*:-

- IA of 60% of QCE deducted from S.I. subject to a

maximum of 70% of S.I. The balance of 30% of S.I. is taxed at the normal corporate tax rate.

- Unabsorbed IA is carried forward until fully utilised.
- Amount of IA utilised is credited to tax exempt account for franking tax exempt dividends
- Pre-commencement expenditure deemed to be incurred on the day business commences.

Capital expenditure is expenditure incurred within 5 years from the date of approval and includes capital expenditure on:-

- plant
- machinery
- fixtures
- premises
- buildings
- structure or works of a permanent nature

It does not include expenditure on the above which is provided for use of a director or a member of the management, administrative or clerical staff.

The following specific features of IA incentive are also available:-

- IA of 80% of QCE against 85% of S.I. for projects located in Sabah, Sarawak and the eastern corridor of Peninsula Malaysia;
- IA of 100% of QCE against 100% of S.I. for projects of national and strategic importance.

(B) S. 127 TAX EXEMPTION

Alternatively, companies undertaking ASP may choose tax exemption incentive under S. 127 of the ACT.

The general features of the tax exemption are:

- Tax exernption of 70% of S.I. for 5 years
- Amount of S.I. exempt from tax is credited to tax exempt account from which tax exempt dividends can be declared
- Unutilised CA cannot be carried forward to the post-exemption period.
- Similarly, unabsorbed losses cannot be carried forward to the post-exemption period.

The following specific features of tax exemption incentive for ASP are also available:

- Companies undertaking ASP in Sabah, Sarawak and the eastern corridor of Peninsula Malaysia qualify for tax exemption at 85% of S.I. for 5 years.
- Companies undertaking ASP of national and strategic importance qualify for tax exemption at 100% of S.I. for 10 years.

IA and S. 127 tax exemption are mutually exclusive.

Applications for incentives

Applications for IA under schedule 7B of the ACT or for exemption under section 127 is made on form BAC 1/96. Completed forms (6 copies) should be submitted to:-

Secretary General
Ministry of Finance
Tax Analysis Division
10th Floor, Block 9, Government Offices Complex
Jalan Duta,
50592 Kuala Lumpur.

OTHER INCENTIVES

Other Incentives For ASP

ASP granted IA or exemption under Section 127 are also eligible for the following incentives:-

- IBA in the form of 10% initial allowance and 2% annual allowance on QCE incurred in construction or purchase of building used for ASP purpose. Claims for IBA are made in the company's annual return.
- Exemption of customs duties and sales tax on imported materials and machinery which are not available locally. (Provided such items are used as direct inputs in the ASP.)
- Exemption of sales tax and excise duty is also available for locally purchased materials and machinery. (Provided such items are used as direct inputs in the ASP.) Claims for exemption of customs duty and sales tax are made on the form BAC 2/96, obtainable from the Tax Analysis Division, Ministry of Finance, Kuala Lumpur.
- In addition, company undertaking ASP is also eligible for :-
  - double deduction on expenses incurred in undertaking R&D activities.
  - double deduction on expenses incurred in the promotion of export of services. Applications are made on the form JHDN/DD 1/96 obtainable from the Technical Division of the IRB.

Exemption of income of certain sectors (under the ACT)

Exemption is given to the following: -

- Income of a resident company carrying on an in bound tour operating business which is registered with the Ministry of Culture, Arts and Tourism. *(Exemption Order -PU (A)1O1)*
  - Exemption is on income from the business of operating group inclusive tours, provided that 500 or more tourists are brought into Malaysia in the year *(effective YA 1996 to 2000).*

- Income of local companies which promote conferences held in Malaysia
  - Number of foreign participants brought into Malaysia must be at least 500 *(effective from YA 1997).*

Double Deduction Of Expenses

Double deduction for the following kinds of expenses are available: -

Promotional Expenses

- Approval expenses incurred for the promotion of exports from Malaysia *(PIA -S. 4I)*
- Expenses incurred outside Malaysia by hotel and tour operators registered with the Ministry of Culture, Arts and Tourism for the promotion of tourism to Malaysia *[Income Tax Rules ("Rules") - PU(A) 412]*
- Expenditure incurred for purpose of participating in an international trade fair held in Malaysia for the promotion of exports, which has been approved by the Ministry of International Trade and Industry. *(Rules - PU(A) 361)*

Export credit insurance premium

- Premium paid on export credit insurance incurred with a company approved by the Minister of Finance *(Rules - PU (A) 562)*

Insurance premium for exporters and importers

- Premium for insurance of cargo imported into Malaysia that is insured with an insurance company incorporated in Malaysia *(Rules - PU (A) 72)*
- Premium for insurance of cargo exported from Malaysia that is insured with an insurance company incorporated in Malaysia *(Rules - PU (A) 79)*

Employment and training of handicapped persons

- Remuneration for employees who are disabled.
- Training of handicapped persons - see section on "Training Incentives."

Research and developments payments allowed under section 34A and 34B of the ACT

- See section on "Incentives for Research and Development."

Interest payable

- Interest payable on loans to a small business. (The loan must be certified to have been approved by the designated authority) *(Rules - PU (A) 422)*

Freight charges

- Freight charges incurred in connection with the export of rattan and wood-based products *(Rules - PU (A) 61)*

Training Incentives

Double deduction is available in respect of expenditure incurred on approved training of employees by a:- *(Rules - PU (A) 6I)*

- Manufacturing company

  (a) Where business has commenced -
  - To qualify, expenditure must be incurred to train employees for the purpose of upgrading and developing employees' skills or increasing productivity or quality of products.

  (b) Where business has not commenced -
  - To qualify, expenditure must be incurred during the pre-commencement period in training employees for the acquisition of skills which will contribute directly to the future production of products of the company.
  - Deduction will be allowed for the year of assessment in which gross income first arises.

  (c) In both the above cases, the training programme must be:-
  - Approved by the Malaysian Industrial Development Authority ("MIDA") or
  - Conducted by a training institution approved by the Minister of Finance.

- Non-manufacturing company
  - The training programme must be
    - approved by MIDA or
    - conducted by a training institution approved by the Minister of Finance

- Company carrying on hotel and tour operating business
  - The training programme must be
    - approved by the Minister of Culture, Arts and Tourism or
    - conducted by a training institute approved by the Minister of Finance
  - Incentive is only available for businesses registered with the Ministry of Culture, Arts and Tourism.

- Training of handicapped persons
  - Expenditure must be incurred in training any handicapped person
    - who must be registered with the Ministry of National Unity And Social Development, and
    - is not an employee of the company.

- Training must be for the purpose of enhancing his employment prospect;
- The training programme must be
  - approved by the Minister of Finance and conducted in Malaysia, or
  - conducted by a training institute approved by the Minister of Finance.

Pre-commencement of business training expenses *(Rules - PU (A) 160)*
A single deduction is allowed in respect of expenses incurred on training potential employees prior to the commencement of business. To qualify for deduction, expenses must be incurred:-

- On training potential employees to impart basic skills to enable the company to commence business
- Within a period of one year prior to commencement of business; and
- Allowable under section 33 ofthe ACT;

Incentives for research and development (R&D)

Double deduction is available for the following types of expenditure incurred in connection with research and development:-

- Expenses of a revenue nature incurred on research directly undertaken by the claimant or on his behalf, approved by the Minister of Finance *(ACT - S34A)*
  - Research must be undertaken in accordance with the needs of the country and bring benefit to the Malaysian ecommy;
  - "Research" has the meaning given to the word as defined in the PIA,
  - Capital expenditure, e.g. expenditure on plant and machinery, land, buildings etc. or in the acquisition of rights over property are excluded.

- Payments to approved research institutes *(ACT-S34B)*
  Payments are of 2 kinds:-
  i) Cash contributions to a research institute or company approved by the Minister of Finance;
  ii) Payments for use of services of approved research institutes, approved research companies, R&D companies or Contract R&D companies.

  - "Research and development company" means a company which provides R&D services in Malaysia to its related company or any other company;
  - "Contract R&D company" means a company which provides R&D services only to a company other than its related company.

PS or ITA for contract R&D Companies

- A contract R&D company is eligible for:-
  - PS incentives with exemption of 100% of S.I. for 5 years *(PIA - S21E)*; or
  - ITA of 100% on QCE incurred within a period of 10 years, deducted against a maximum of 70% of S.I. *(PIA - S29D)*
- QCE for ITA purposes

Type of Research	
Manufacturing based	**Agriculture based**
Expendiutre on - factory - plant and machinery (used in Malaysia)	Expenditure on - clearing and preparation of land - planting trial crops - irrigation or drainage systems - plant and machinery - access roads (including bridges) - buildings (excluding living accommodation or buildings for welfare of person - structural improvements on land

ITA for R&D companies *(PIA - S29E)*

- A research and development company is eligible to apply for ITA which allows:-
  - 100% of QCE incurred within a period of 10 years and
  - is to be deducted against a maximum of 70% of S.I.
- QCE for ITA purposes
  - same as in **PS or ITA for contract R&D Companies**

ITA for in-house research *(PIA - S29F)*

- Companies which carry out in-house research are eligible to apply for ITA which allows:
  - 50% of QCE incurred within a period of 10 years and
  - is to be deducted against a maximum of 70% of S.I.
- QCE for ITA purposes
  - same as in QCE for ITA purposes. (above)

Capital allowance and industrial building allowance ("IBA")
A building used for the following kinds of research are eligible for IBA: -

- research approved by the Minister of Finance under S34A & S34B of the ACT (see **Incentives for research and development [R&D]**)
- research undertaken by a company that is approved for IAA purposes (see **Industrial Adjustment Allowance ("IAA")** above)
- research undertaken by a R&D company or a contract R&D company. (see under **Payments to approved research institutes (ACT - S34B)** above) *(Para 37B, schedule 3 of ACT)*

Applications

The following table summarizes the forms used and what they are to be submitted:

INCENTIVE	FORM	SUBMITTED TO
Double deduction on revenue expenditure for approved research projects under section 34A.		
Application for Approval of project	DD1/RD/ 1997	Director General Inland Revenue Board Technical Division 15th Floor, Government Offices Complex, Jalan Duta 50600 Kuala Lumpur
Claim for double deduction	Annual return	Branch of IRB to which return is submitted.
Double deduction on cash contributions to approved research institutions under section 34B		
Application for: Approved status on research institute		Secretary General of Treasury Ministry of Finance Tax Analysis Division Block 9, 10" Floor Jalan Duta 50592 Kuala Lumpur
Status as R&D company or Contract R&D company.	R&D1	Director General MIDA (See address in Applications for PS or ITAabove)
Claim for double deduction	DD2/RD/ 1997	IRB (submitted with tax return)
Pioneer status or investment tax allowance for contract R&D company or ITA for R&D companies	R&D1	Director General MIDA
ITA for in-house research	R&D2	Director General MIDA

ABBREVIATIONS:

ACT	- Income Tax Act 1967	QCE	- Qualifying Capital Expenditure
A.I.	- Adjusted Income	S.I.	- Statutory Income
ASP	- Approved Service Project	SMI	- Small-scale Manufacturing Company
CA	- Capital Allowance	wef	- With Effect From
IBA	- Industrial Building Allowance	YA	- Year of Assessment
PIA	- Promotion of Investments Act 1986		

The following is an extraction of the minutes of meeting of the Consultative Panel between the Royal Customs and Excise Department and Private Sector which was held on 15 May, 1997.

Jabatan Kastam Dan Eksais Di Raja Malaysia

Minit Mesyuarat
PANEL PERUNDINGAN KASTAM/SWASTA 2/96

BAHAGIAN II

PERKARA-PERKARA BERBANGKIT

Perkara 1 : Senarai Pegawai, Nombor Telefon dan Faks

Intisari Perbincangan

FMFF menyarankan supaya Jabatan menyediakan satu senarai pegawai, no. telefon, dan no. faks bagi tujuan rujukan syarikat-syarikat yang berurusan dengan Jabatan. Untuk tujuan ini Unit Perhubungan Awam dan pihak FMFF adalah dipohon untuk menguruskan penerbitan buku tersebut.

Keputusan

Unit Perhubungan Awam menjelaskan bahawa draf buku panduan telefon tersebut tidak dapat disiapkan lebih awal disebabkan maklumat lengkap khususnya mengenai wakil-wakil swasta ke Mesyuarat Panel Perundingan Kastam/ Swasta masih belum diperolehi sepenuhnya. Bagaimanapun senarai ahli jawatankuasa semua pertubuhan/persatuan telahpun diperolehi sepenuhnya. Draf juga mengandungi butir-butir terkini mengenai penempatan anggota Kastam ekoran daripada perlantikan/ pertukaran beberapa pegawai tertinggi Jabatan Kastam termasuk Ketua Pengarah dan Timbalan-timbalan Ketua Pengarah baru-baru ini.

Memandangkan tiada pihak lain yang sanggup untuk membantu di dalam penerbitan buku ini, urusan tersebut akan diuruskan sepenuhnya oleh Unit Perhubungan Awam dan urusan percetakan oleh Percetakan Nasional Berhad.

Tindakan : Unit Perhubungan Awam

Perkara 2 : ATA Carnet

Intisari Perbincangan

MICCI membangkitkan masalah *ATA Carnet* dan sering mendapat teguran daripada pihak Dewan Perniagaan Antarabangsa kerana pengesahan dokumen yang tidak sempurna atau tidak betul. Ini mungkin disebabkan pegawai-pegawai kastam di stesen-stesen import kurang pengetahuan mengenai cara-cara mengesahkan dokumen *ATA Carnet*. Sehubungan dengan itu satu kursus berkaitan dengan *ATA Carnet* dan Import Sementara telah diadakan pada 14.11.96 di Ibu Pejabat, Jalan Duta, yang telah dihadiri oleh 14 orang Pegawai Kanan Kastam dari seluruh negara. Kursus tersebut telah dikendalikan oleh Cawangan Latihan dan Pembangunan Kerjaya, Ibu Pejabat Kastam dengan kerjasama Bahagian Kastam dan MICCI. Kursus ini bertujuan untuk melatih Pegawai Kanan sebagai *trainers* yang mana mereka akan mengendalikan *in-house training* di stesen masing-masing berhubung dengan *ATA Carnet* dan Import Sementara.

Keputusan

Selepas kursus tersebut dilaksanakan satu tinjauan telah dijalankan dan didapati bahawa:

a) Pegawai-pegawai Kanan Kastam yang dilatih telah melatih kakitangan di stesen masing-masing melalui latihan sambil kerja (*In-house training*). Latihan-latihan tersebut akan terus dilaksanakan dari masa ke masa apabila berlaku pertukaran kakitangan di stesen-stesen berkaitan.

b) Stesen-stesen kastam juga telah menyediakan Carta Aliran Kerja Prosesan *ATA Carnet* dan agihan borang *ATA Carnet*.

Untuk makluman

Perkara 3 : Pelaksanaan SMK di ICD Sg. Way

Intisari Perbincangan

Kontena Nasional meminta penjelasan mengenai kedudukan pelaksanaan SMK di ICD Sg. Way.

Keputusan

Bahagian Sistem Maklumat Pengurusan menjelaskan kedudukan seperti berikut:

i) Bagi ikrar CUSDEC K1, pihak EDI Malaysia sedang membuat persediaan bagi memasang *Frontend software* di premis ejen penghantaran yang berurusan dengan Kastam ICD, Sg. Way.

ii) Bagi ikrar CUSDEC K8 dan K9, ujian terakhir antara EDI Malaysia (*Frontend software*) dengan SMK masih dijalankan dan ada beberapa *error* code yang timbul yang sedang diselidiki dan diperbaiki di peringkat *frontend software.*

Untuk Makluman

Perkara 4 : ***Tariff Rate Under CEPT Scheme For Purchases Of Component Parts/Raw Material From LYW or FZ***

Intisari Perbincangan

FMM mencadangkan supaya pembeli/pengimport menikmati kemudahan kadar tarif di bawah skim CEPT bagi pembelian komponen/bahan mentah yang dibekalkan oleh Gudang Pengilangan Berlesen (GPB) atau Zon Bebas (ZB). Sehubungan dengan itu Jabatan bersetuju kadar CEPT bagi barang-barang daripada ZB dan GPB yang dijual di Kawasan Utama Kastam. Walau bagaimanapun setelah merujuk kepada pihak Peguam Negara didapati perundangan yang ada pada masa ini perlu diubahsuai untuk membolehkan barang-barang daripada ZB dan GPB layak mendapat kadar duti di bawah Perintah Duti Kastam (Barang-barang Berasal dari Negeri-negeri ASEAN) Tarif Keutamaan Samarata 1995. Jabatan sedang mengambil tindakan untuk meminta Perundangan berkenaan.

Keputusan

Jabatan telah menyediakan Pindaan kepada Perintah Duti Kastam (Barang-barang Berasal dari Negeri-Negeri ASEAN)(Tarif Keutamaan Samarata) 1995. Pindaan tersebut melibatkan banyak perubahan kepada peruntukan-peruntukan di bawah Perintah CEPT kerana mengambil kira:

a) Definasi Zon Bebas yang perlu dimasukkan di dalam Perintah tersebut.

b) Mewujudkan peruntukan-peruntukan yang lebih mirip kepada pengeksportan dari sebuah Zon Bebas ke Persekutuan dan

c) *prosedur pengeluaran Sijil Tempasal.*

Proses pindaan undang-undang merupakan satu proses yang rumit dan mengambil masa yang lama. Dengan yang demikian, Jabatan sedang berurus dengan Perbendaharaan untuk memberi kemudahan yang dipohon dengan kaedah yang lebih mudah.

Tindakan : Cawangan Zon Bebas dan Kawalan GPB.

Perkara 5 : Peruntukan Bagi Perkhidmatan Kesetiausahaan *(Company Secretariat Services)*

Intisari Perbincangan

MIA membangkitkan masalah ketidak seragaman pengenaan cukai terhadap perkhidmatan kesetiausahaan syarikat. Menurut Jadual Kedua, Peraturan-peraturan Cukai Perkhidmatan 1995, disahkan bahawa perkhidmatan kesetiausahaan syarikat bukanlah merupakan perkhidmatan yang ditetapkan. Oleh yang demikian ia tidaklah tertakluk kepada cukai perkhidmatan. Walau bagaimanapun perkhidmatan tersebut yang disediakan oleh pelesen akauntan awam adalah tertakluk kepada cukai perkhidmatan disebabkan perkhidmatan kesetiausahaan syarikat (*company secretarial services*) dianggap sebagai perkhidmatan profesional yang biasa disediakan oleh akauntan awam. Perkhidmatan yang disediakan oleh tempat-tempat perniagaan professional

lain yang ditetapkan seperti syarikat *consultancy* juga tertakluk kepada cukai perkhidmatan. Memandangkan terdapat ketidak seragaman di dalam perkara ini, satu kajian akan dijalankan.

Keputusan

Kajian terhadap ketidak seragaman pengenaan cukai perkhidmatan ke atas perkhidmatan kesetiausahaan syarikat telahpun siap dijalankan. Kerajaan seterusnya akan memberi pertimbangan mengenai perkara ini.

Tindakan : Cawangan Cukai Perkhidmatan

Perkara 6 : Bahan-bahan Rujukan/maklumat Awam Dicetak oleh pihak swasta.

Intisari Perbincangan

Bahagian Perkhidmatan Teknik memohon jasa baik pihak swasta untuk membantu Jabatan dalam penerbitan bahan-bahan maklumat bagi mengurangkan tanggungan Jabatan. Bahan-bahan maklumat ini adalah juga untuk edaran kepada pihak swasta.

Memandangkan tiada respon daripada pihak swasta, Tuan Pengerusi memberi tempoh sebulan untuk pihak swasta menghubungi terus Pengarah Bahagian Perkhidmatan Teknik sekiranya ingin menyumbang. Sekiranya tidak ada respon daripada pihak swasta, Jabatan terpaksa meneruskan pengurusan dengan pihak Percetakan Nasional yang mana pengedaran bahan-bahan kelak lambat dan tidak menyeluruh disebabkan kos yang tinggi.

Keputusan

Sehingga kini masih tiada respon daripada pihak swasta berkenaan perkara ini. Oleh yang demkian Jabatan mengambil keputusan untuk meneruskan pangurusan dengan pihak Percetakan Nasional Berhad.

Untuk makluman

PERKARA-PERKARA YANG DIBINCANGKAN

Penjenisan *Spinel*

MICCI membangkitkan masalah sebuah syarikat yang mengeluarkan *refractory Material*. Masalah yang dibangkitkan adalah mengenai penjenisan spinel (MgO Al 1203) yang di bawah *sub heading section II Inorganic acids and inorganic oxygen compounds of non metal* kepada *main heading section VI products of the chemicals or allied industries*. MICCI mendakwa barangan ini tidak diliputi di bawah *Malaysian Trade Classification and Customs Duties Order*. Disebabkan masalah pengurusan ini syarikat yang mengimport terpaksa membuat bayaran duti secara bantahan bagi tujuan pelepasan.

Keputusan

Spinel adalah *metamorphic mineral of igneous rocks* yang didapati secara semula jadi. Dengan yang demikian *spinel* adalah sejenis *mineral substance* dengan general formula $MgAl_2O_4$. Memandangkan dagangan ini didapati secara semula jadi maka ia tidaklah di dalam keadaan *pure state* dan mengandungi bahan-bahan lain seperti tercatat dalam *Raw Material Specifications* yang dikemukakan oleh MICCI. Berdasarkan kepada *Raw Material Specifications* yang dikemukakan oleh MICCI komposisi *spinel* adalah terdiri daripada Al_2O_3(76%), MgO(23%), CaO(<0.3%), Fe_2O_3(<0.1%), SiO_2(0.06%) dan Na_2O(<0.15%). Daripada senarai komposisi tersebut *spinel* mungkin tidak dalam keadaan *separate chemically defined* dan kod tarif 2825.90 000 mungkin tidak sesuai. Sebaliknya ia mungkin lebih sesuai sebagai *mineral substances* di bawah kod tarif 2530.90 900.

Memandangkan syarikat telah mengimport dan membayar duti secara bantahan ke atas dagangan berkenan, Jabatan akan menghantar contoh dagangan tersebut kepada Jabatan Kimia untuk dianalisis. Bagi memastikan tindakan sewajar ke atas bayaran duti secara bantahan telah diambil oleh stesen yang berkenaan adalah dicadangkan pengimport mengemukakan salinan Borong ikrar Kastam yang berkaitan ke Cawangan Pengurusan Penjenisan, Ibu Pejabat dengan segera.

Tindakan : Cawangan Pengurusan Penjenisan

Pengenaan Duti Ke atas *exfoliated materials* seperti *vermiculite, expanded clays* dan lain-lain.

MICCI membangkitkan mengenai pengenaan duti import ke atas bahan-bahan mentah contohnya *exfoliated materials* seperti *vermiculite, expanded clays* dan lain-lain yang dirasakan tidak wajar. Ini adalah disebabkan pengimportan barangan siap yang diperbuat daripada bahan-bahan ini tidak dikenakan duti.

Keputusan

Vermiculite adalah *micaceous mineral* yang didapati secara semula jadi yang dikategorikan sebagai *mineral substance* di bawah KT.2530.10 000. la tidak tertakluk kepada duti import atau cukai jualan. Walau bagaimanapun, *vermiculite* yang melalui proses *heat treatment which causes a very large expansion of the material* adalah dikenali sebagai *expanded or exfoliated vermiculite* dan sesuai diperjeniskan di bawah KT.6806.20 000 yang tertakluk kepada duti import 25% dan cukai jualan 10%. Bagi *vermiculite* yang dijadikan barang siap seperti *blocks, sheets, bricks, tiles, tubes, cylinder shells, cords, pads* adalah sesuai diperjeniskan di bawah KT.6806.90 000 yang juga berduti import 25% dan cukai jualan 10%.

Dengan yang demikian penyataan pengimportan bahawa barangan siap diperbuat daripada *Vermiculite* tidak tertakluk kepada duti import dan cukai jualan adalah tidak tepat.

Untuk makluman

Pengikraran Eksport

MICCI meminta penjelasan sama ada borang eksport K2 perlu ditandatangani secara manual memandangkan pengikrarannya tidak dibuat secara elektronik. Sekiranya perlu, bolehkah ejen penghantaran yang dilantik menandatangani bagi pihak pengimport? Adakah ini juga meliputi permohonan untuk *drawbacks*?

Keputusan

Bagi pengeksort-pengeksport yang mengemukakan borang ikrar bukan secara elektronik, pengeksport masih perlu menandatangani borang ikrar secara manual. Amalan sekarang di mana pengeksport melantik ejen penghantaran untuk menguruskan pengeksportan dan ejen yang dilantik dibenarkan menandatangani borang ikrar bagi pihak pengeksport masih diteruskan. Walau bagaimanapun dalam keadaan di mana pengeksport memohon *drawback*, notis tuntutan tarik balik duti/cukai perlu ditandatangani oleh pengeksport.

Untuk makluman

Pindaan Terhadap Definisi Gudang Pengilangan Berlesen Di bawah Akta Cukai Jualan 1972.

FMM dan MIA menjelaskan di dalam Belanjawan 1997 baru-baru ini, pindaan telah dibuat terhadap Akta Cukai Jualan 1972 berkenaan definisi Gudang Pengilangan Berlesen (GPB). Dengan pindaan tersebut, GPB hendaklah disifatkan sebagai suatu tempat di luar Malaysia (Seksyen 2B). Oleh yang demikian GPB tidak lagi perlu dilesenkan di bawah Akta Cukai Jualan 1972. Sebagai bukan pelesen GPB tidak lagi dapat menikmati kemudahan-kemudahan seperti berikut:

a) Pembelian bahan mentah melalui pihak ketiga (kemudahan CJ5)

b) Menjalankan kerja sub-kontrak dengan pelesen Cukai Jualan (Kemudahan CJ 5B)

c) Jualan tempatan Keluaran GPB berdasarkan Seksyen 7(1)(d). Ini bermakna cukai jualan akan bertambah dan harga jualan juga turut meningkat.

Oleh yang demikian FMM dan MIA menggesa Jabatan supaya mengkaji dan seterusnya memperbaiki keadaan ini.

Keputusan

Jabatan sedar dan faham mengenai kedudukan ini. Jabatan akan menjalankan satu kajian dan seterusnya mengemukakan cadangan kepada pihak Perbendaharaan sebelum belanjawan akan datang.

Tindakan : Cawangan Cukai Jualan

Rekod Akaun Bahan-bahan Komponen Dan Bahan Pambungkusan Yang Dikecualikan Cukai Jualan.

FMM menjelaskan syarikat yang memohon pengecualian cukai jualan terhadap pembelian bahan mentah melalui CJ Pentadbiran 2 (CJP2) dikehendaki mengemukakan penyata bulanan sebelum 10 haribulan pada setiap bulan. Proses penyediaan penyata ini menambahkan tugas-tugas pentadbiran dan kos. Bagaimanapun penggunaan kemudahan CJ5 tidak memerlukan pengemukaan penyata bulanan. Oleh yang demikian FMM mencadangkan supaya penyata bulanan tidak perlu dikemukakan dan memadai dengan pengilang menyimpan rekod-rekod untuk tujuan pemeriksaan akaun di premis-premis.

Keputusan

Pengilang barang-barang terpilih dikenakan syarat supaya menyimpan rekod-rekod berkaitan pembelian dan pengimportan bahan mentah untuk tujuan pemeriksaan akaun. Pejabat ini telah menghubungi stesen yang terlibat dan mengarahkan supaya keperluan menghantar penyata bulanan oleh pengilang berkenaan diberhentikan serta-merta. Untuk tujuan keseragaman semua stesen telah dimaklumkan mengenai perkara ini.

Tindakan : Cawangan Cukai Jualan

USUL USUL DARIPADA JABATAN KASTAM.

Cadangan mengenakan Bayaran Ke Atas Permohonan Penjenisan Pra-Pengimportan.

Cawangan Pengurusan Penjenisan mencadangkan supaya mengenakan bayaran perkhidmatan dan caj yang dikenakan oleh pakar ke atas orang awam/syarikat yang mengemukakan permohonan penjenisan pra-pengimportan ke ibu pejabat.

Cawangan Pengurusan Penjenisan menjelaskan bahawa bilangan permohonan penjenisan pra-pengimportan yang dikemukakan oleh orang awam/pengimport adalah besar jumlahnya jika dibuat perbandingan dengan jenis-jenis permohonan lain. Daripada permohonan ini sebahagian besarnya pula perlu dibuat rujukan/analisis oleh pakar-pakar daripada Jabatan Kimia/JKR/SIRIM/RRI/FRIM dan sebagainya. Kos analisis ini dibiayai sepenuhnya oleh Jabatan. Dalam konteks ini Jabatan hanya memberi perkhidmatan (penyalur) tanpa mendapat sebarang kepentingan.

Di samping melibatkan kos, Jabatan juga terpaksa mengambil masa untuk memproses permohonan ini kerana pemohon tidak memberi maklumat-maklumat yang mencukupi semasa membuat permohonan. Ekoran daripada keadaan ini Jabatan terpaksa berhubung dengan pemohon berulang kali untuk mendapatkan maklumat/contoh dan sebagainya. Dalam banyak hal, pemohon tidak memberi respon yang positif.

Dengan mengenakan bayaran perkhidmatan dan *charge* pakar ke atas setiap permohonan penjenisan pra-pengimportan, Jabatan percaya hanya permohonan yang benar-benar memerlukan kod penjenisan akan diambil tindakan. Dengan cara ini masa boleh dijimatkan dan Jabatan dapat membuat penjenisan dengan cepat dan tepat.

Keputusan

Setelah diperbincangkan hal ini, beberapa penetapan telah dibuat.

i) Permohonan penjenisan yang terlibat hanyalah permohonan pra-pengimportan sahaja.

ii) Masa untuk memproses sesuatu permohonan penjenisan adalah bergantung kepada keputusan rujukan yang dibuat kepada pakar-pakar seperti Jabatan Kimia/JKR/SIRIM/RRI/FRIM dan sebagainya. Sekiranya permohonan tidak perlu dirujuk kepada pakar, masa yang diambil oleh Jabatan untuk memproses adalah sebagaimana yang ditetapkan di dalam 'Piagam Pelanggan'.

iii) Pemohon akan diberitahu sekiranya permohonan mereka dihantar kepada pihak pakar. Jabatan akan memproses permohonan sebaik sahaja jawapan diterima daripada pihak pakar mengikut jangka masa yang ditetapkan di dalam 'Piagam Pelanggan'.

iv) Bayaran minima akan dikenakan terhadap perkhidmatan yang diberi oleh Jabatan dan juga caj yang dikenakan oleh pakar. Jabatan akan mengemukakan cadangan ini kepada Perbendaharaan. Bayaran sebenar yang dikenakan akan ditentukan oleh

Perbendaharaan kelak. Bayaran perkhidmatan ini adalah bagi memastikan pihak pemohon benar-benar 'serius' terhadap permohonan mereka bagi membolehkan permohonan yang benar-benar memerlukan kod penjenisan sahaja diambil tindakan.

Tindakan : Cawangan Pengurusan Penjenisan

UCAPAN PENUTUP PENGERUSI

Dato' Pengerusi mengucapkan ribuan terima kasih kepada semua ahli mesyuarat yang telah sama-sama menyumbang idea dan pendapat. Beliau memohon maaf sekiranya ada kata-kata yang menyinggung perasaan ahli semasa beliau mengendalikan mesyuarat. Beliau juga mengingatkan ahli swasta supaya memberi kejasama kepada pihak sekretariat dalam mengemukakan maklumat-maklumat yang diperlukan terutama sekali maklumat keahlian untuk tujuan tapisan keselamatan. Beliau seterusnya mengajak semua ahli supaya melaksanakan apa yang telah sama-sama diputuskan di dalam mesyuarat. Akhir sekali beliau sekali lagi mengucapkan terima kasih dan salam kepada semua yang hadir.

(MD. HALID SIRAJ)
Setiausaha,
Panel Perundingan Kastam/
Swasta,
Ibu Pejabat
Kastam dan Eksais Diraja,
Malaysia.

(DATO' HJ AHMAD PADZLI MOHYIDDIN)
Pengerusi,
Panel Perundingan Kastam/Swasta,
Ibu Pejabat
Kastam dan Eksais Diraja,
Malaysia.

Continuation from page 10

branch). The notification shall be accepted immediately (within three hours) unless there are errors in documents submitted. A business plan, a joint venture contract or a resolution of meeting of the board, a certificate of nationality, and the notification form need to be submitted.

In the case of restricted businesses, the relevant ministry will review the business plan, which will normally be processed within 15 days; however, most application are processed within 5 days in practice. Same documents are needed to be submitted as the notification procedure.

In either case, the minimum investment amount is 50 million Won as the minimum capital requirement for domestic corporations. In addition, the minimum price for a stock is five thousand Won.

The remittance of profits by foreign invested firms is not controlled. Also, remittance of dividends by a Korean subsidiary can be freely made.

NOTE:
This paper was circulated at the AOTCA seminar held in Philippines on 7 November 1997.

COURTESY VISIT TO INLAND REVENUE

En Ahmad Mustapha Ghazali presenting the honorary fellowship certificate to Pn Najirah Tassaduk Khan

On 19th September 1997, a delegation from the Institute led by the President of the Institute, En Ahmad Mustapha Ghazali with other Council members, En Michael Loh, En Hamzah HM Saman, En Harpal Singh Dhillon, Tn Hj Abdul Hamid and Cik Teh Siew Lin, paid a courtesy visit to the Director General/Chief Executive Officer of Inland Revenue, Pn Najirah Tassaduk Khan to present the "Honorary Fellow" status to her. The President and the Council members also took this opportunity to congratulate Pn Najirah on her appointment as the Chief Executive Officer of the Inland Revenue Board (IRB).

During the meeting, En Ahmad Mustapha Ghazali briefed Pn Najirah on the Institute's activities, development, status as well as their future plans. En Ahmad Mustapha in particular, mentioned that the examinations of the Institute will hopefully help ensure the high standards of tax professionals. He also thanked Pn Najirah and the IRB for allowing their officers to be involved in the many Committees of the Institute.

Pn Najirah at the meeting pointed out that as the Inland Revenue has corporatised, it could provide better services to the taxpayer. The IRB also aims to educate taxpayers on their role. Pn Najirah was of the opinion that both the Inland Revenue and the MIT should maintain a good relationship and support each other as both have the same mission of improving the tax administration for the benefit of the public. She also offered the Board's support should the Institute require assistance.

Before leaving, En Ahmad Mustapha Ghazali thanked Pn Najirah for taking some time from her busy schedule to meet them.

Pn Najirah Tassaduk Khan (seated centre) and En. Ahmad Mustapha Ghazali (on her right) posing with IRB Senior Officers and MIT Council members.

Exchange of Information ... (left to right) En Hamzah Saman, Tn Hj Abdul Hamid, En Ahmad Mustapha Ghazali with Pn Najirah Tassaduk Khan.

BUDGET 1998 Activities

The Institute had again jointly with Malaysian Institute of Accountants (MIA), organised a number of events in conjunction with the Budget. Immediately after the Finance Minister, YAB Dato' Seri Anwar Ibrahim presented the Budget at 3.00p.m. on 24th October 1997, a flurry of activities followed. A brief press release was prepared and sent to all major newspapers. Two hours after the end of the Budget speech, MIT Vice President Mr Chow Kee Kan together with MIA representatives, Mr Lee Yat Kong and Mr Neoh Chin Wah represented their respective Institutes in a phone-in interview with the News Straits Time Group NST(G).

The 1998 Budget was given great attention due to the economic and currency crisis faced by the nation. Proposals in the 1998 Budget reflected the Government's seriousness in addressing important issues in the current economic crisis and it is believed to bring about long term economic growth.

The Institutes were pleased that a number of proposals submitted were taken up in the Budget. Among the proposals were :-

- The reduction of the number of years for raising backdated assessment from twelve to six years; and
- The levy on foreign workers to be given to the tax payer as a rebate.

On the next day the Institutes as in previous years organised a Budget Hotline service in collaboration with the NST(G) to assist members of the public who sought clarification and information on the Budget. The Hotline Service lasted about three hours and ended at 12 noon as scheduled. There were 80 - 100 calls and the majority were interested to know when the proposed measures would be effective. The other enquires were on general issues. The Institute would like to take this opportunity to thank the listed Hotline Handlers for their valuable contribution in the 1998 Budget activities. They are:

Peter Huntsman
KPMG Peat Marwick

Christoper Chang
Kassim Chan & Co

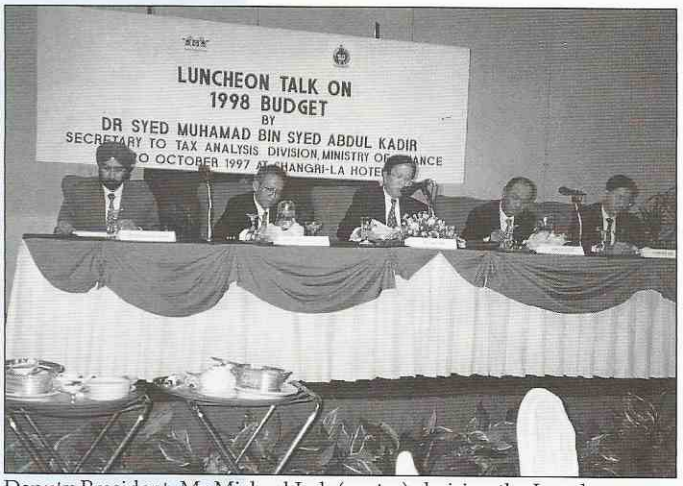
Gabriel Kua
Kassim Chan & Co

Foong Chooi Keng
Ernst & Young

Selvaraj s/o Dhanapalu
Coopers & Lybrand

Bong Sesh Chin
Price Waterhouse

Bernard Yap
Arthur Andersen



Deputy President, Mr Michael Loh (centre) chairing the Luncheon Talk. On his left is Council Member, Mr Kang Beng Hoe (immediate left) and MIT Vice-President Mr Chow Kee Kan. On Mr Loh's immediate right is Deputy Secretary of the Tax Analysis Division, Tn Hj Ithnin Hj Hassan and MIT Council member, Mr Veerinderjeet Singh.

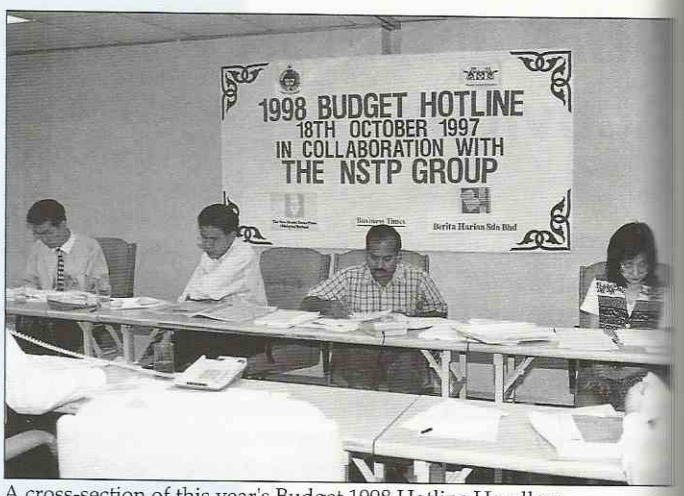
A press conference was also held at the same day where the Institute was represented by Council members, Mr Quah Poh Keat and Mr Kang Beng Hoe and MIA President Y Bhg Dato' Hanifah Noordin, Mr Neoh Chin Wah and Mr Lee Yat Kong on behalf of Malaysian Institute of Accountants.

Y Bhg Dato' Hanifah Noordin said that competitiveness could be enhanced by a bigger reduction in the corporate tax to at least 26 percent for it is a very important factor to the foreign investor. Mr Quah Poh Keat who is also the Chairman of the MIT Technical and Public Practice Committee said that there is a maturity in the tax administration which is reflected in the measures for re-investment allowance.

In conjunction with the 1998 Budget, a Luncheon Talk jointly organised by MIT and MIA was held at Shangri-La Hotel Kuala Lumpur on 20th October 1997. The response to the Luncheon Talk was positive especially with the presence of Tn Hj Ithnin Hj Hassan, the Deputy Secretary who attended on behalf of Dr Syed Muhamad bin Syed Abdul Kadir, the Secretary to the Tax Analysis Division, Ministry of Finance. He presented an overview on the 1998 Budget and this was followed by an active questions and

Mr Lee Ah Puan of the Customs Department enlightening the participants regarding changes in the Budget 1998.

Budget 1998 Press Conference (from left to right) MIA Council Members, Y Bhg Dato' Dr Lau Ban Tin, Mr Neoh Chin Wah, MIA President, Y Bhg Dato' Hanifah Noordin, MIT Council Members, Mr Quah Poh Keat, Mr Kang Beng Hoe and Mr Lee Yat Kong



A cross-section of this year's Budget 1998 Hotline Handlers

answers session. The function was chaired by MIT Deputy President Mr Michael Loh. The panel speakers comprised of MIT Vice President Mr Chow Kee Kan and council members, Mr Veerinderjeet Singh and Mr Kang Beng Hoe. Various questions pertaining to tax issues and issues from the 1998 Budget were raised by the members who attended the talk. At the end of the function, Mr Michael Loh announced that there will be a similar function organised every year on Tuesday immediately after the release of the Budget. He encouraged members to attend these talks as an avenue to obtain clarification and more information regarding the annual Budget.

To conclude the Budget activities, MIT and MIA in collaboration with Majlis Sukan Kebajikan Kastam organised a series of half-day seminars around the country to provide an update and detailed insight into the 1998 Budget, which commenced from 21st October to 13th November 1997. This seminar was conducted by Mr Richard Thornton, Director and Training, Total Approach Sdn Bhd, Mr Lee Ah Puan, Ms Mangaiyarkarasi and Mr Ho Chang Seng the Director and the Assistant Directors of Technical Services Division, Royal Customs and Excise Malaysia respectively.

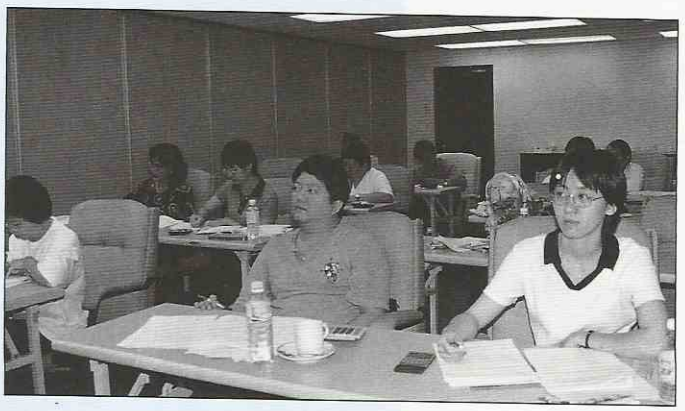
INTENSIVE REVISION COURSE

Among the many activities the Institute had arranged for the students in preparation for the December 1997 MIT examination was an intensive revision course for the Taxation I to V papers.

This revision course basically covered the complete syllabus of the papers and dealt with many difficult aspects, which are significant to the examination. Emphasis was also placed on the examination techniques.

The course leader, Ms Ong Yoke Yew was selected for her many years of involvement in training and lecturing in the subject of Malaysian Taxation. Her substantial practical tax experience with international accountancy firms and the corporate sector allows her to give a more practical approach in her teaching.

The revision course was held at the MIA premises, YMCA (Brickfields) as well as at the KLC School of Business and Professional Studies. Students had classes from 9 to 5 p.m. for 2 days for each paper except for Taxation III which was held for 3 days. The course leader also gave out materials as well as Questions and Answers for the papers, which would assist the students in preparation for their examination.



Students listening intently to the lecturer

The course was well received by the students and this was shown clearly with students coming from as far as Johor and Pahang. The Institute hopes to conduct similar courses for the benefit of its students in the coming years.

The Institute also takes this opportunity to wish success to all students who are sitting for the 1997 MIT Examinations which will be held from 15 to 19 December 1997 and held throughout Malaysia.

MEMBERSHIP OF MIT AS AT 25 NOVEMBER 1997

The following persons have been admitted as associate members of the Institute as at 25 November 1997.

NAME	MEMBERSHIP NO.
Lee Yan Hoon	1423
Yong Chee Min	1424
Tee Guan Pian	1425
Karen Margaret D'Aranjo	1426
Jerome Tan Thiam Poh	1427
Soon Kok Seng	1428
Zainal Abidin Arifin	1429
Chong Toong Ming	1430
Joseph s/o Anthony	1431
Parandaman a/l S. Jayaraman	1432
Ho Lai Fun	1433
Bulvir Singh a/l Pritam Singh	1434
Lim Beng Keat	1435
Abd Rahman Said Alli	1436
Yow Kok Chaw	1437
Soo Kwai Heong	1438
Teh Kam Weng	1439
Loke Sik Chee	1440
Tiang Kung Seng	1441
Soh Chow Seng	1442
Siau Yen Su	1443
Harry Anak Entebang	1444
Kan Hong Ling	1445
Ji Soon Hin	1446
Tan Beng Huat	1447
Au Kok Hing	1448
Chook Kim Hoe	1449
Chua Tia Guan	1450
Wan Mohamad Shukri bin Wan Ab Kadir	1451
Leong Yim Kuen	1452
Teo Puay York	1453
Patrick Chan Sze Wei	1454
Lydia Shalani a/p Cecil Thiagarajah	1455

MEMBERSHIP STATUS OF MIT AS AT 25 NOVEMBER 1997

Honorary Fellows	7
Fellows	232
Associate Members*	1214
	1446

*** Associate Members**

Public Accountants of MIA	712
Registered Accountants of MIA	154
Licensed Accountants of MIA	8
Advanced Course Exam of IRD	92
Advocates & Solicitors	6
Approved Tax Agents	78
MIT Graduates	1
Others	170
Deceased/Resigned	(7)
	1214

The following persons have been admitted as fellow members of the Institute as at 25 November 1997.

NAME	MEMBERSHIP NO.
Quah Cheng Choon	45
Hng Chai Heng	67
Lum Tuck Cheong	71
Choong Yan Tai	72
Clotilde Davidine D'Cruz	74
Chai Meng Fatt	75
Yeoh Guan	76
Loke Yee Seng @ Loke Yik Kwang	77
Leong Ah Kow @ Leong Siew Mun	79
Lau Chin Park	82
Kan Siew Chun	83
Tan Yong Chang	84
Christopher Sim Peak Soon	85
Chia Chin Seng	88
Ab. Halim Bin Mohyiddin	90
Lee Sik Ngee	91
Thomas Kong Thau Khiong	92
Tan Peng Chay	93
Tiong Mee King	94
Tan Tiong Hwee	95
Lee Hooi Seng	96
Pun Kheng Hock	97
Mary Geraldine Phipps	98
Lim Kai Siang	100
Tan Kark Bin	102
Ling Liong Huong	103
Liew Jui Hee	104
Ngu Woo Hieng	105
Ho Yun Kong @ Ho Yun Hee	107
Cheong Kam Tho	108
Lee Keh Thiam	109
Lim Ba @ Lim Kim Cheong	115
Yap Ping Kon	116
Ngu Ying Ping	118
Khoo Peng Lai	121
Loh Boon Eng	123
Abdul Jabbar Bin Abdul Majid	124
Felix Tan Soon Kim	125
Chua Kian Sinn	128
Teh Wee Hong	129
Subramaniam s/o Muthusamy	130
Baldev Singh a/l Gurdial Singh @ Nikah Singh	131
Wong Tsu Shi	133
Battchoo Ratilal a/l Ratilal Hirachand	134
Tan Kek Wah @ Tan Kheok Hua	136
Lee Teik Swee	137
Sit Kam Hock	138
Mah Kwong Keong	139
Ong Ewe Kok	140
Ch'ng Keok Tong	141
Kang Tatt Yow	142
Jeyapalan a/l Kasipillai	144
Chong Fook Sin	145
Foo Boon Fong	146
Tan Chin Hock	148
Thanneermalai a/l SP SM Somasundaram	149
Vallatharasu s/o A.S. Ganapathi	150
Kok Chan Chuan	151

MEMBERSHIP OF MIT AS AT 25 NOVEMBER 1997

NAME	MEMBERSHIP NO.
Ong Teng Ping	153
Mathew Keralavakayil Mathai	155
Tey Sah Fah	156
Chan Ah Hing @ Chan Eng Chaw	157
Kong Fui Kien	158
Cheong Siew Kai	160
Lee Lee Kim	161
Chen Kit Lin @ Chen Keat Lim	162
Ng Choon Theong	163
Liew Yow Keong	165
Ngan Yeeng Bee	166
Ng Seing Liong	167
Ho Ah Seng @ Ho Tham Seng	168
Wang Shi Tsang	169
James Loh Ching Yew	170
Chen Foo Siong	171
Cheong Siew Keong	172
Teng Woon Soon	173
Liaw Chee Shing John	174
Hassan Bin Hj Taib	175
Yeoh Poh Yew	178
Kok Fong Meng	182
Ng Kian Chong	184
Tsen Keng Yam, Adrian	185
Wong Seng Chong	188
Ling Lee Chuong	189
Chin Chew Wong	190
Mah Siew Seng	191
Khor Siam Huat	193
Eng Tee Sing	194
Manharlal Bhaichand Gathani Jain	196
Wong Yeng Mun	198
Tan Ah Moi	200
Mary Lee Siew Cheng	202
Lee Fook Hong	203
Lum Chee Keong	205
Arumugam a/l Gurusamy	206
David Wong Siew Chow	207
Ngu Liong Chui	208
Wong Hon Kai	210
Tan Jin Swee	212
Omar Arif Abdullah @ John R Dixon	213
Chan Yoke Ying	214
Toh Seng Thong	216
Tan Teck Leong	217
Su Lim	218
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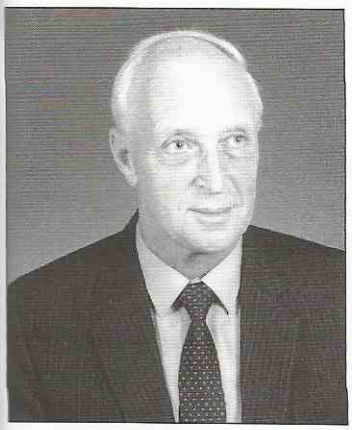


THE TAXATION OF OVERSEAS INCOME

Prepared by:
Richard Thornton

With the enactment of section 3C of the Income Tax Act 1967 ("the Act"), effective from year of assessment 1995, a substantial change was made to the scope of charge to tax on overseas income. This topic is still important after the 1998 Budget (see the explanation in the final paragraph).

SCOPE OF CHARGE

The key to the taxing of overseas income is the charging provision in s.3 of the Act, which sets out the general rule. Unlike many countries which use the World-scope basis of taxation, Malaysia operates what is known as the derived and remitted basis. Income tax is charged on income accruing in or derived from Malaysia or received in Malaysia from outside Malaysia.

One significant exception to the general rule applies to the income of a Labuan offshore company. To prevent any overlap with the Labuan tax regime, income tax is not charged on income in respect of an offshore business activity carried on by an offshore company (section 3B).

Further modifications apply to some kinds of overseas income received in Malaysia from outside Malaysia:

- a non-resident person, whether a company or not, is exempt from income tax in respect of such income (para. 28, Schedule 6)
- a resident company is not charged to tax on income received in Malaysia from sources outside Malaysia if the company is not carrying on the business of banking, insurance, shipping or air transport (section 3C).
- a resident person carrying on the business of banking, insurance, shipping or air transport is taxable in Malaysia on all of his income from carrying on those activities, wherever derived (the World-scope basis)(sections 54,60 and 60C) and on overseas income of other types when it is received in Malaysia

THE TAXPAYER

Before considering the question of taxability of overseas income it is necessary to know who we are dealing with. Apart from anything else, we must know whether the person is non-resident and entitled to the benefit of the exemption under Schedule 6 or, in the case of a company, whether resident so as to qualify under section 3C.

We also need to know whether the person entitled to the income is a company and, if so, what type of company. For income tax purposes, a company means a body corporate and includes any body of persons established with a separate legal identity by or under the laws of a territory outside Malaysia.

EXAMPLE 1

A Malaysian resident trust received dividends in Malaysia from a Korean company in 1996.

The trust body is deemed to be a person (under section 61 of the Act), but it is not a company. Being a resident, the trust body cannot enjoy the benefit of any exemption and is liable to tax on the actual amount received at the rate appropriate to a trust body (30% for year of assessment 1997).

THE NATURE OF THE INCOME

For a resident company, we must find out what kind of business it is carrying on. If it carries on the business of banking, insurance, shipping or air transport it is taxable in Malaysia on all of its income from carrying on those activities, wherever derived. Furthermore, such a company does not qualify under section 3C and will be chargeable to tax on the normal basis in respect of overseas income of other types when it is received in Malaysia.

EXAMPLE 2

A Hong Kong company resident in Malaysia has no business activity in Malaysia but carries on a business of manufacturing and selling cane furniture outside Malaysia. During 1996, the company received in Malaysia overseas income in the form of trading profits and dividends.

Because the company is resident in Malaysia, the company is resident in Malaysia, section 3C applies and it is not liable to tax on overseas income received in Malaysia.

It should be noted that the mention in section 3C of banking, insurance, shipping or air transport business does not relate to the type of income received. The question is whether the company itself is carrying on a business of that

particular nature. It does not matter where the company is carrying on the business or whether it also carries on other types of business. If the company in Example 2 had also been carrying on a shipping business in Hong Kong, it would not have qualified for the exemption under section 3C in respect of its trading profits and dividends received in Malaysia.

THE SOURCE OF INCOME

Unless we have found out exactly where the income comes from, we are not in a position to know how to deal with it.

If the source is in Malaysia, or is deemed to be in Malaysia, then it is not overseas income and not within the scope of this article. There are many situations in which income is deemed to be derived from Malaysia. For example, where a company resident for the basis year for a year of assessment pays, credits or distributes a dividend in that basis year, the dividend is deemed to be derived from Malaysia. The consequence is that the paying company is required to deduct tax and the dividend is treated as income of the recipient.

Otherwise, normal tax principles should be used to determine the location of the source.

EXAMPLE 3

Ravi and Suresh are Malaysians with an interest in motor cars and they believe that they can make money by bringing cars from the United Kingdom, where Suresh is now studying, and selling them in Malaysia, Suresh will source the cars whilst Ravi will import the cars and market them in Malaysia. They will only handle about six to ten choice models per year and will use a bank loan to supplement their own financial resources for the purpose.

Ravi and Suresh have an intention to make profits. That, and the existence of a number of 'badges of trade', indicates that they are intending to carry on a business. They will be carrying on business in common with a view to profit and therefore in partnership. The partners are in two different countries and decisions may be split between the two. However, the principal transactions, sale of the cars, will take place in Malaysia, which will be the location of the business source. The income will not be foreign income.

RECEIVED IN MALAYSIA

These words are not defined by the Act and have not been considered by the Courts in Malaysia but there are a number of foreign cases which, although not binding, can be used as guidance. The word 'received' cannot be construed too narrowly. It can be taken to mean not just cash received but a receipt, for example a bank remittance, in a form which is usual in commercial transactions. An isolated book entry is not a receipt but agreed compensating cross-entries in the books of parties who owe each other money has been held to amount to 'receipt'. If the income does not belong to the relevant person when it is received in Malaysia because he has given it away before that time then it is not received by him.

Practical difficulties can arise when income is not remitted to Malaysia as soon as the person becomes entitled to it. If it is mixed together with non-income funds in the same account, there arises the problem of identification of any withdrawal. Also, if the money is first used for a capital purpose overseas, such as investment, it may be contended that it ceases to be income.

An interpretation which helps to overcome a number of these difficulties is the 'doctrine of first receipt' based on decisions made by the Privy Council in certain Indian cases (e.g Pondicherry Railway Co. Ltd. v CIT (5 ITC 363)). The essence of this doctrine is that income can only be received once by the person entitled to it. What is to be implied from this is that if the person receives the income outside Malaysia, for example into an overseas bank account, any subsequent dealings with the money cannot be construed as receipt of the income in Malaysia. it cannot be said for certain that this interpretation would be accepted in Malaysia in the absence of judicial interpretation.

SECTION 3C AND DISTRIBUTION OF INCOME

As has been stated above, section 3C has been effective from year of assessment 1995 and its effect is to exclude from tax the overseas income of a resident company received in Malaysia from outside Malaysia, provided that the company is not carrying on the business of banking, insurance, shipping or air transport.

It should be noted that section 3C applies at the time of receipt of the income in Malaysia. Therefore, it can be assumed that income arising overseas before the basis period for year of assessment 1995 will not be liable to tax if it is received in Malaysia after the section took effect. Although the section is intended to be a permanent provi-

sion, its repeal at some time in the future cannot be ruled out. Therefore, it would be wise to remit substantial amounts of overseas income to Malaysia at the earliest opportunity in case the section is repealed in the future.

With the disappearance of liability to tax goes the disappearance of double tax relief. Where the overseas income has borne overseas tax, a credit for the foreign tax would most likely have been available if the income had been liable to Malaysian tax. Credit can only be given against a liability to tax on the relevant income and the foreign tax will now go unrelieved.

Without some other provision, companies enjoying tax-exempt overseas income might have problems in distributing that income to their shareholders. By definition, such a company is a resident of Malaysia, its dividends are deemed to be derived from Malaysia and should be paid under deduction of tax. The effect of Income Tax (Exemption)(No.31) Order 1995 (PU (A) 450) is to allow such companies to pay out the income exempted by section 3C as exempt dividends.

EXAMPLE 4

In 1996, a company received in Malaysia overseas income of RM700 and the income was exempt under section 3C. This was the only income of the company and, as required by its controlling shareholder, it distributed its profits after tax in full during 1996. (No foreign tax was suffered, no expenses were incurred and the company had no section 108 balance).

Without the benefit of the exemption order, the company would have a liability to tax of RM210 (700 at 30%). A net dividend of RM490 could be paid (RM700 less tax deducted at 30%, RM210) and the tax on the company's income would satisfy the deduction of tax from the dividend. What was tax-exempt income has now become taxable due to distributing it.

With the benefit of the exemption order, the exempt income of RM700 can be distributed as a tax exempt dividend to the shareholder and the shareholder, if it is also a company, can distribute the tax-exempt income up to its own shareholder(s).

As in the case of other exempt dividend provisions, the exempt income is only two tier exempt. A company shareholder may distribute it again but the exemption does not endure beyond that.

SUMMARY OF INCOME LIABLE TO TAX

By eliminating the types of overseas income exempt from tax, we are able to summarise what is still taxable. Overseas income of the following 'persons' is still subject to tax:

- income of a resident company from the business of banking, insurance, shipping or air transport, whether derived from Malaysia or not, and whether received in Malaysia or not
- all other types of income of a resident company engaged in the business of banking, insurance, shipping or air transport, when received in Malaysia
- income of a resident individual when received in Malaysia
- income of the trust body of a resident trust when received in Malaysia
- income of any other resident person or body of persons (except a body of persons established with a separate legal identity by or under the laws of a territory outside Malaysia) when received in Malaysia.

This article was written before the tabling of the 1998 Budget and the accompanying Finance (No. 2) Bill 1997. The Bill, which has not yet become law, proposes to delete section 3C of the Act with effect from year of assessment 1998. Income Tax (Exemption) (No. 48) Order 1997, which was gazetted recently, is made under section 127 of the Act and has the effect of replacing the deleted section without change, except that it will also apply to unit trusts. The full text of the exemption order is reproduced for easy reference.

INCOME TAX ACT 1967
INCOME TAX (EXEMPTION) (No. 48) ORDER 1997

Act 53

In exercise of the powers conferred by paragraph 127(3)(b) of the Income Tax Act 1967, the Minister makes the following rules:

Citation and commencement.

1. This order may be cited as the **Income Tax (Exemption) (No. 48) Order 1997** and shall have effect from the year of assessment 1998.

Exemption from tax

2. The Minister exempts a resident company (other than a company carrying on the business of banking, insurance, sea and air transport) and a unit trust from the payment of income tax in respect of income derived from sources outside Malaysia and received in Malaysia by that resident company or unit trust.

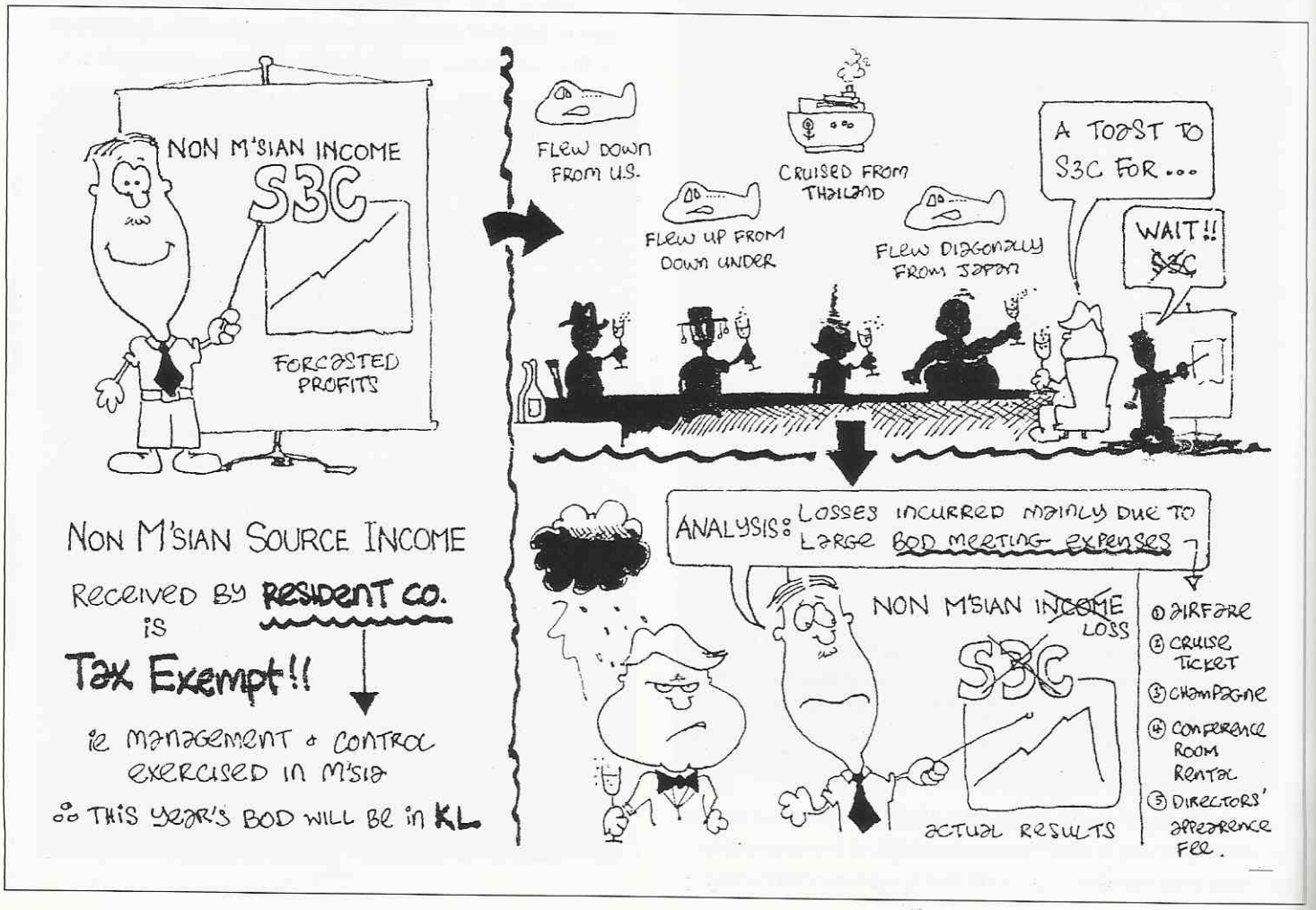
Application of paragraph 5 and 6 of Schedule 7A

3. Paragraph 5 and 6 of Schedule 7A to the Act shall apply *'mutatis mutandis'* to the amount of income derived and received by resident company or unit trust exempted under paragraph 2 of this Order

Made 31 October 1997.
[Perb. CR (8.09) 294/6/4-9 (SJ. 5) Vol. 2; PN. (PU²) 80/XXV;LHDN. 01/35/(S)/42/51/259-14.].

ANWAR IBRAHIM,
Minister of Finance

(To be laid before the Dewan Rakyat pursuant to subsection 127(4) of the Income Tax Act 1967.)



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