



CHARTERED TAX INSTITUTE OF MALAYSIA (225750 T)
(Institut Percukaian Malaysia)

PROFESSIONAL EXAMINATIONS

FINAL LEVEL

ADVANCED TAXATION 2

DECEMBER 2019

Student
Registration No.

Date

Desk No.

Examination Centre

Time allowed: 3 hours

INSTRUCTIONS TO CANDIDATES

1. You may answer this paper **EITHER** in English **OR** in Bahasa Malaysia. Only **ONE** language is to be used.
2. This paper consists of **SIX** questions. **Candidates are ONLY REQUIRED TO ANSWER FIVE QUESTIONS.**
3. The Income Tax Act 1967 (as amended) is referred to as ITA.
4. Each answer should begin on a separate answer booklet.
5. All workings **MUST** be shown as marks will be awarded.
6. Answers should be written in either black or blue ink.
7. No question paper or answer booklets are to be removed from the examination hall.

DO NOT TURN OVER THIS PAGE UNTIL INSTRUCTED BY THE INVIGILATOR

Question 1

- (a) In an effort to encourage Malaysian companies to become more innovative in adapting existing technologies and creating new technologies, local companies which carry out research and development (R&D) activities are entitled to claim double tax deduction on their R&D expenditure.

Required:

State the circumstances under which double deduction can be given in respect of R&D under:

- (i) **section 34A of the ITA; and** (3 marks)
- (ii) **section 34B of the ITA.** (4 marks)
- (b) Top Berhad intends to set up Top R&D Sdn Bhd to cater for the increasing R&D needs of one of its subsidiaries, Top Manufacturing Sdn Bhd. Top R&D Sdn Bhd is expected to spend RM20 million on qualifying capital expenditure in year 1. Top Manufacturing Sdn Bhd will pay R&D fees of RM3m per year for 5 years to Top R&D Sdn Bhd.

Required:

Advise the management of Top Berhad whether Top R&D Sdn Bhd should apply for Investment Tax Allowance incentive.

Provide calculations of the total amount deductible (excluding capital allowances) together with the indication of tax saving for the entire 5 years.

(7 marks)

- (c) JX Amalgamated Sdn Bhd (JXA), a Malaysian tax resident company, was incorporated in 2017 with a paid-up ordinary share capital of RM10 million. It set up a factory in Kluang to manufacture steel products and started its operation on 1 July 2017. The Malaysian Investment Development Authority had granted JXA pioneer status and the production day was 1 July 2018 as stated in the pioneer certificate. JXA prepares its financial statements to 31 August annually. Approved research expenditure incurred and to be incurred by JXA are as follows:

Year of Assessment	Qualifying research expenditure RM' million	Adjusted income (before taking into account the research expenditure) RM' million
2017	10	30
2018	10	35
2022	8	40
2024	8	30

Required:

- (i) **Explain how JXA could be efficient in maximising the qualifying research expenditure to be incurred during the pioneer period.** (2 marks)
- (ii) **Compute the adjusted income of JXA for the years of assessment 2017 and 2024 taking into account any deduction due on the qualifying research expenditure.**

(4 marks)

[Total: 20 marks]

Question 2

- (a) With reference to the provisions of the ITA explain briefly the 'hallmark of tax avoidance' and the 'hallmark of tax mitigation' mentioned by *Lord Nolan* in the United Kingdom case of *IR Comrs. v Willoughby* [(1997) 4 All ER 65].

(5 marks)

- (b) Ravi Energy Malaysia Bhd ['REM'] is a local listed company, incorporated to carry on the business of generating electric power for the domestic grid under a special arrangement with the Government of Malaysia. The business is considered a high-risk adventure. On account of the huge capital outlay required to finance, construct and operate the power plant, REM raised funds by way of equity, shareholder's borrowings (loan stock) and third-party borrowings. In respect of the shareholder's borrowings, the company has an obligation to pay interest at the rate of 15% on the loan stock [the current market rate for a similar amount borrowed from a commercial bank is 8%]. A substantial part of the loan stock was taken up by the directors of REM and the balance by non-resident third party lenders.

For the years of assessment 2017 and 2018, the company incurred and paid interest of RM30 million on the loan stock for each of those years to the loan stock holders. In the respective returns submitted to the Inland Revenue Board, the amount was claimed as 'interest expense on loan stock' under section 33 in arriving at the net profit for those two years of assessment. The company closes the account to 30th June each year.

On 16th September 2019, the Director General of Inland Revenue [DGIR] disallowed the interest on the loan stock for years of assessment 2017 and 2018 and raised additional assessments with penalty for the two years of assessment.

Required:

- (i) Identify the contentious issue (or issues) in the case of Ravi Energy Malaysia Bhd in the context of the ITA for the years of assessments 2017 and 2018.
- (3 marks)
- (ii) Explain whether the arrangement made by Ravi Energy Malaysia Bhd in respect of the borrowing by way of loan stock is an attempt at tax avoidance or tax evasion.
- (3 marks)
- (iii) Explain the basis for the Director General of Inland Revenue to issue an additional assessment for the years of assessment 2017 and 2018 by disallowing the interest expenses claimed.
- (3 marks)
- (iv) Explain whether the Director General of Inland Revenue is justified in imposing a penalty when issuing the said additional assessment for the years of assessment 2017 and 2018.
- (3 marks)
- (c) In an instance where the Director General of Inland Revenue has reason to believe that a particular transaction has an element of tax avoidance in it, how would the Director General go about to counteract the effect of that transaction on that person or any other person.
- (3 marks)

[Total: 20 marks]

Question 3

- (a) Explain the concept of “Residence” under Article 4 of the OECD Model Convention. (3 marks)
- (b) Paragraph 2 and 3 of Article 4 covers “tie-breakers rules” for individuals and companies respectively.
- (i) Outline how the residency status of an individual is determined. (4 marks)
- (ii) Outline how the residency status of a company is determined. (4 marks)
- (c) ABC Group which operated through ABC Pte Ltd is a closely held Malaysian based multinational group. It has foreign subsidiary companies within the group. Majority of the directors in the foreign subsidiaries generally reside in Malaysia.

The key management personnel of ABC Pte Ltd are generally based in Malaysia and are on the Board of all the foreign subsidiaries. The foreign subsidiaries take all the key management decisions in its board of director meetings.

Discuss the residency status of the foreign subsidiaries in the following scenarios:

- (i) The directors of the foreign subsidiaries travel to foreign jurisdictions to attend all the board of director’s meetings in which key management decisions are made. (3 marks)
- (ii) 3 out of 4 of the board of director’s meetings are held in Malaysia. (3 marks)
- (iii) The directors of the foreign subsidiaries at times attend the board of director meetings through video conferencing from Malaysia. (3 marks)

Extract of the OECD Model Convention

OECD Model Convention

Article 4

RESIDENT

1. For the purposes of this Convention, the term “resident of a Contracting State” means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof as well as a recognised pension fund of that State. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.
2. Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then his status shall be determined as follows:
 - a) he shall be deemed to be a resident only of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident only of the State with which his personal and economic relations are closer (centre of vital interests);
 - b) if the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident only of the State in which he has an habitual abode;
 - c) if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident only of the State of which he is a national;
 - d) if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.
3. Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavour to determine by mutual agreement the Contracting State of which such person shall be deemed to be a resident for the purposes of the Convention, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by this Convention except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting States.

[Total: 20 marks]

Question 4

- (a) Resale price method is one of the transfer pricing methodologies used. Describe the features of the resale price method and when it is approximately applied using a simple illustration to explain your answer.**

(10 marks)

- (b) Q, a Malaysian company manufactures an electronic chip P1 under its valuable patent rights at a cost of RM8.00 per electronic chip and sells them to A, its foreign subsidiary. Q makes no other sales of electronic chips other than electronic chip P1 in foreign markets. A resells the electronic chip P1 in a foreign market without further processing at RM14.00 each.**

Several uncontrolled distributors in the business of exporting products similar to electronic chip P1 typically earn a commission of 20 percent on the purchase and sale of their products.

- (i) Compute the arm's length price on the sale of electronic chip P1 using the resale price method.**

(5 marks)

- (ii) What adjustments are needed to the gross profit margin if there are material differences in the controlled and uncontrolled sales that would affect the margin.**

(5 marks)

[Total: 20 marks]

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Question 5

- (a) GSS Sdn Bhd provides bookkeeping services and has consistently invoiced its clients a total of RM35,000 per month since 2015. Due to its prudent management, GSS Sdn Bhd has accumulated a sizeable surplus of funds. In October 2018, GSS Sdn Bhd decided to use these funds to acquire a commercial building which in turn generated a monthly rental income of RM8,000 from November 2018. GSS Sdn Bhd has a financial year ending on 31 December.

- (i) **Discuss the liability of GSS Sdn Bhd to register under Service Tax Act 2018.**

(3 marks)

GSS Sdn Bhd managed to secure four new clients in 2019, including its first overseas client based in Singapore, and entered into service contracts with the new clients to provide its bookkeeping service which will be invoiced in the beginning of the months listed in the table below. GSS Sdn Bhd's bookkeeping fees from each of the new clients is RM5,000 per month.

Client name	Date
Charming Sdn Bhd	February 2019
Targo Pty Ltd	March 2019
Indigo Sdn Bhd	April 2019
Mega Sdn Bhd	August 2019

- (ii) **Discuss implications of the above addition invoicing on the liability of GSS Sdn Bhd to register under the Service Tax Act 2018.**

(5 marks)

- (iii) **What are the implications if Indigo Sdn Bhd is a wholly-owned subsidiary of GSS Sdn Bhd?**

(5 marks)

- (iv) **Assuming Indigo Sdn Bhd is a wholly-owned subsidiary, describe the following If GSS Sdn Bhd has a liability to register:**

a. **The deadline for registration.** (1 mark)

b. **The effective date of its registration.** (1 mark)

c. **The first taxable period and the deadline for the filing of the first service tax return.** (1 mark)

d. **The deadline to pay any service tax payable arising from the first service tax return.** (1 mark)

- (b) After securing Targo Pty Ltd as a client, GSS Sdn Bhd decided to set-up an office in Singapore. It rented a commercial property in May 2019 and paid an equivalent of RM2,000 as monthly rental for the commercial property. In addition, GSS Sdn Bhd engaged an outsourcing service provider in June 2019 and pays a monthly equivalent of RM3,000 for employment and payroll services.

Discuss the implications of service tax on these payments.

(3 marks)

[Total: 20 marks]

Question 6

- (a) Article 5 (5) of the UN Model under the agency clause, an enterprise should be deemed to have a permanent establishment (“PE”) in a State if there are under certain conditions, a person acting for it, even if no fixed place of business is at the disposal of the enterprise.

What are the elements that must exist to constitute an agency PE? Explain each element of an agency PE.

(10 marks)

- (b) **In what situations are an enterprise not deemed to have an agency PE according to Article 5 (7) of the UN Model and explain your understanding of these situations.**

(5 marks)

- (c) X is the sales representative of a non-resident firm in State M. X visits customers and arranges for orders. All of the terms and conditions of an order – price, quantity, delivery, etc. – are settled by X. However, the order is made either via an email or fax to the firm’s head office for official approval. The orders are approved as a matter of course.

State your position with basis to support your arguments whether X is a PE of the firm or not.

(5 marks)

[Total: 20 marks]

(END OF QUESTION PAPER)