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

PROFESSIONAL EXAMINATIONS

FINAL LEVEL

ADVANCE TAXATION 1

JUNE 2018

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) **Based on the Inland Revenue Board Public Ruling No 1/2015 Clubs, Association or Similar Institutions, explain the differences between members' club and proprietary club.**

(3 marks)

(b) **Explain the tax treatment of profits derived from members' clubs and proprietary clubs.**

(4 marks)

(c) Big Bike Club members own high capacity motorcycles ranging from 1700cc and above. They operate a café in the premises, selling food and beverages to its members.

Required:

(i) **Explain the "mutuality principle".**

(3 marks)

(ii) **Using the mutuality principle in (i), explain how profits generated from the club's café is being taxed.**

(4 marks)

(d) For the year ending 2017, Cancer Survivors Club received entrance fees of RM8,000 and subscriptions fees of RM80,000. The club regularly holds seminars on healthy living and receives fees from non-members who attended these events. Seminar fees from non-members amounted to RM40,000 for the year.

The club incurred the following expenses; hall rental RM15,000, salaries and wages RM24,000, administrative charges of RM15,000 and postage, stationery printing of RM15,000.

Required:

Compute the chargeable income for year of assessment 2017 for Cancer Survivors Club.

(6 marks)

[Total: 20 marks]

Question 2

Reinvestment allowance (RA) is an incentive given to companies under Schedule 7A of the ITA for certain qualifying projects. The Malaysian income tax authorities closely scrutinise RA claims made by businesses during tax audits.

In respect of the above statements, provide appropriate answers to the following:

(a) **How does a company qualify for RA and state the types of conditions required for its eligibility?**

(4 marks)

(b) **Explain the rationale for a company in choosing the Reinvestment Allowance incentive over other tax incentives available under the Malaysian tax legislations.**

(4 marks)

(c) Raina Footwear Sdn Bhd (RFSB) is a company located in Johore and it manufactures footwear. RFSB is planning to expand its production lines to meet the extensive demand for its footwear in Malaysia.

RFSB's budgeted profits and capital expenditure in 2018 and 2019 are shown below:

	2018 (RM'000)	**2019 (RM'000)**
Adjusted income/(loss)	1,980	7,200
Capital allowances	560	1,200
Rental Income (net)	65	58
Approved donations	15	10
Projected capital expenditure:		
Land in Segamat	2,000	Nil
Factory	3,000	1,500
Plant and machinery	1,200	400

RFSB is entitled to 60 percent of the qualifying expenditure to be offset against 70 percent of the company's statutory income.

Required:

Calculate the reinvestment allowance claim and compute the chargeable income of RFSB incorporating reinvestment allowance for years of assessment 2018 and 2019.

(12 marks)

[Total: 20 marks]

Question 3

Secure Rich Investment Trust (SRIT) is a real estate investment trust company (REIT) approved by the Securities Commission. It is listed on the Malaysian Stock Exchange and makes up its accounts to 31 December annually.

SRIT derives income from the following:

a. Rental income from letting out commercial lots in a city mall;

b. Rental from a double storey factory unit in a rapidly developing industrial estate, all of which are actively used for manufacturing activities by the tenants.

The income statement of SRIT for the year ended 31 December 2017 was as follows:

Secure Rich Investments Trust Income Statement for the year ended 31 December 2017		
	RM'000	**RM'000**
Rent from malls		12,000
Rent from factories		80
Interest		36
Dividends		14
Total gross income		12,130
Less: Expenditure		
Audit fee	31	
Depreciation	38	
Management fee	1,244	
Property maintenance charges	1,221	
Secretarial fee	5	
Trustee administration fee	54	
Other expenses	911	3,504
Net profit		8,626

The '**other expenses'** of RM911,000 claimed in the accounts are fully deductible for income tax purposes under section 33 of the ITA.

Further, a sum of RM300,000 was available as capital allowance on assets used by the trust in the course of carrying on its business activities, including allowance on the factories let out.

Required:

(a) **Based on the accounts provided, compute the total income of SRIT for the year of assessment 2017 with reference to the ITA.**

Note:
Label the figures comprising the stages of the computation and indicate, by the use of the word 'nil' to any item shown in the income statement which is not taxable or not deductible.

(8 marks)

(b) **The Board of Directors plan to distribute RM7million to the unit holders on 15 February 2018. What would be the the tax liability of SRIT for the year of assessment 2017 under section 61A(1) of the ITA?**

(4 marks)

(c) **Explain how the distribution from SRIT be taxed under the ITA for the year of assessment 2017:**

(i) **For Malaysian resident companies unit holders**

(4 marks)

(ii) **For individual Malaysian resident unit holders**

(4 marks)

[Total: 20 marks]

Question 4

(a) Property development is generally viewed as a specialised industry. As such, specific rules for taxation of property development business is laid out in the Income Tax (Property Development) Regulations 2007. This Regulation amongst others prescribes the rules for taxation and recognition of income for a property development business or project.

Required:

Explain the rules and method for ascertaining the income subject to income tax in each basis period in respect of a property development project undertaken by a property developer.

(6 marks)

(b) M Development Sdn Bhd was incorporated on 1 June 2017 and shortly thereafter on 1 July 2017 signed a joint venture agreement with a landowner to develop a piece of commercial land owned by the landowner into service apartments. Upon signing the joint venture agreement, M Development Sdn Bhd started to engage consultants to assist with the planning of the development. On 15 November 2017, application for Development Order (DO) was submitted to the local authority and the DO was approved on 30 January 2018. The piling works started on 15 February 2018 and the sales was officially launched on 1 March 2018.

Required:

Explain the basis to determine whether a property development business has commenced and state with reasons the date of commencement of the business for M Development Sdn Bhd.

(4 marks)

(c) TMG Land Sdn Bhd completed a shop house development project in 2017. Out of 100 units of shop houses developed, 99 units have been sold. The Management decided to keep one unsold unit and consequently, transferred it to investment property at the end of the 2017 financial year. The transfer to investment property was at development cost value of RM1 million. The market price of the unsold unit was RM2 million at the time of transfer.

After two years, the investment property was disposed of for RM4 million.

Required:

Explain the income tax implications of the transfer of the unsold unit to investment property and subsequent disposal of the investment property.

(6 marks)

(d) Jeju Sdn Bhd, a property developer, has 10 units of unsold terrace houses recognised as inventory in its balance sheet. Jeju has not been able to sell these units despite active marketing efforts. In the meantime these units were rented out to derive rental income.

Jeju Sdn Bhd also recently purchased a vacant land for a future property development project. Currently, the land is rented out to a third party for car park operation.

Required:

What is the income tax treatment for the rental income derived from letting out the unsold terrace houses and also the vacant land held for future development?

(4 marks)

[Total: 20 marks]

Question 5

(a) Ravi Leasing Sdn Bhd ('the company') is a Malaysian resident company carrying on the business of leasing plant and machinery to the construction industry. It closes the accounts to 31 December each year.

On 1 January 2016 the company leased a heavy machine to Mega Builders Sdn Bhd under a lease agreement for three (3) years commencing from the same date i.e. 1 January 2016. The machine cost was RM20,000 and the leasing charges was RM3,600. Mega Builders Sdn Bhd will pay a monthly lease rental of RM800 for the whole of the lease period.

Owing to a downturn in the construction industry, Mega Builders Sdn Bhd decided to terminate the lease agreement on the heavy machine on 30 June 2017. The company then pulled out the heavy machine and disposed it to Zahara Construction Sdn Bhd (an unrelated third party) for RM9,000.

The company has an interest income from a fixed deposit in a local commercial bank. The interest received for the year ended 31 December 2016 was RM600 and for the year ended 31 December 2017, it was RM700.

The company had made a cash donation to an approved charitable body of RM100 for the year ended 31 December 2016 and RM150 in 2017:

Required:

Compute the chargeable income of Ravi Leasing Sdn Bhd for the years of assessment 2016 and 2017 in the following situations:

(i) The Director General of Inland Revenue does not invoke Paragraph 71 of Schedule 3 in respect of the heavy machine disposed of;

(ii) The Director General of Inland Revenue invokes Paragraph 71 of Schedule 3 in respect of the heavy machine disposed of.

(8 marks)

(b) HM Leasing Sdn Bhd ('the company') is a Malaysian resident company carrying on the business of leasing in mainly heavy machineries and closes its accounts on 31 December each year. In the year 2017, it entered into a lease arrangement in respect of four assets, namely Asset A, B, C and D. These assets are heavy engineering equipment and earth moving machines that qualify for capital allowance at 20%.

The relevant information regarding the lease of the assets are as follows:

Asset A

The lease was for a period of 50 months and the monthly rental due in the year 2017 was for 12 months. The monthly rental in respect of the machine which costs RM55,000 was RM1,600. During the year, the lease rental received was only RM17,600 and a sum of RM1,600 was in arrears as at 31 December 2017. The finance income for the year was RM11,000.

This asset was an asset previously owned by the lessee. It was sold to the company and then leased back in order to assist with the lessee's cash flow problems.

Asset B

This machine was installed at the lessee's premises as part of a stand-alone extended production facility fulfilling a special engineering requirement. The installation was such that this machine cannot be removed for another lessee's use unless it is fully dismantled from the existing structure.

This asset cost RM78,000 and was leased out for 70 months (of which six months fall in 2017) at a monthly rental of RM1,900. The lease rental received during the year was RM11,400 and the finance income was RM9,000.

Asset C

This asset was leased out for 36 months, commencing from April 2017, under a variable lease payment arrangement i.e. the lessee will pay RM3,100 per month for the first 24 months and RM3,300 in the months thereafter. The lessee will not have beneficial ownership or options to purchase the asset at the end of the lease term.

Asset D

This lease is treated by the company as a finance lease but it is not a sale agreement within the meaning of the Income Tax Leasing Regulations No. 4. Accordingly, the company had recognised only the finance income of RM7,000 received for the year in the accounts. The lease was effective from August 2017 for a period of 48 months.

Other information

It is the policy of the company not to recognize arrears of lease rental as income, and accordingly not brought into account in the profit and loss account. While the company has furnished financial income in respect of the various assets leased out, these are not used in the determination of the company's profits.

The unabsorbed capital allowance brought forward from the previous years of assessment in respect of the leasing business was RM1,000 while the common capital allowance for the current year of assessment was RM10,000. The common unabsorbed loss brought forward was RM9,000.

The '**Other Expenses'** charged in the accounts refer to allowable common expenses and are fully deductible within the meaning of section 33 of the ITA.

The donation was a cash contribution to an approved charitable body in Malaysia.

The company's profit before tax was arrived at as follows:

HM Leasing Sdn Bhd		
Profit and loss account for the year ended 31 December 2017		
	RM	**RM**
Lease rental for Assets A, B and C	53,800	
Finance income of Asset D	7,000	60,800
Less: Expenses		
Depreciation of leased assets	25,000	
Other expenses	6,000	
Donations	200	31,200
Profit before tax		29,600

Required:

(i) Explain with reference to the Income Tax Leasing Regulations of 1986 whether the respective lease agreements are deemed to be a lease or non-leasing business for the year of assessment 2017.

(3 marks)

(ii) State the critical point in respect of Asset B that would determine whether it constitutes a lease or a sale agreement.

(3 marks)

(iii) Based on the Income Tax Leasing Regulations 1986, explain in respect of the company who is the lessor, the income tax treatment that would apply in a non-deemed sales situation and a deemed sales situation.

(3 marks)

(iv) Explain for Asset C how will the Director General of Inland Revenue account for the income received for the variable lease payments by the company during the lease period for the year of assessment 2017.

(3 marks)

[Total: 20 marks]

Question 6

(a) In a contract, how is the disposal date determined under the RPGT Act , if:

(i) There is a written contract and;

(ii) There is no written contract.

(iii) State which provision of the RPGT Act examines the determination of the disposal date.

(2 marks)

(b) How do you define the date of completion of disposal?

(2 marks)

(c) Meridian Sdn Bhd purchased a piece of land on 8 May 2014 for RM3.6 million. On 12 September 2017, Meridian Sdn Bhd entered into a sale & purchase agreement with Orion Express Sdn Bhd to sell the land for RM6 million. Orion Express Sdn Bhd paid RM300,000 as deposit and the balance by way of bank borrowings. Due to strict banking requirements, Orion Express Sdn Bhd was unable to obtain the end-financing to pay the balance of the purchase price to Meridian Sdn Bhd and the deposit was forfeited.

Meridian Sdn Bhd subsequently engaged a real estate agent to advertise the land for sale and incurred advertisement cost of RM5,000. Meridian Sdn Bhd managed to sell the land to Channel Five Sdn Bhd for RM6.8 million. Channel Five Sdn Bhd paid RM400,000 as deposit and a sale & purchase agreement was entered on 1 February 2018. Channel Five Sdn Bhd will pay the balance of the purchase price by 8 equal instalments over a period of 4 years. The real estate agent is entitled to a commission of 3% of the sale proceed upon the completion of the sale & purchase agreement on the sale of the land.

Compute the chargeable gain and real property gains tax (RPGT) payable on the disposal of the said land.

(9 marks)

(d)

(i) What is the RPGT treatment if a real property is disposed of as a gift from a parent to a child.

(ii) What are the conditions that need to be satisfied that would result in no gain or loss position for the donor?

(iii) State which provision of the RPGT Act governs the treatment of gift.

(3 marks)

(e)

(i) What is the value of the real property to be taken up by the recipient if it is acquired by way of gift in the above scenario in item (d)(i)?

(ii) Explain why the tax treatment is accorded in the manner that you have described.

(4 marks)

[Total: 20 marks]

(END OF QUESTION PAPER)