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

PROFESSIONAL EXAMINATIONS

FINAL LEVEL

ADVANCE TAXATION 2

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) A taxable person is allowed to claim input tax which is attributable to taxable supplies. However, input tax attributable to incidental exempt financial supply is also claimable as if the input tax is attributable to taxable supplies.

(i) **Company XYZ is a manufacturing company. The company is making wholly taxable supplies. It has bought a car for the manager. Can Company XYZ claim Input tax for the car? If yes, can Company XYZ claim input tax after 1st June 2018? If Company XYZ is not allowed to claim input tax, explain why?**

(1.5 marks)

(ii) **List five (5) exempt financial supplies where the input tax is claimable as if the input tax is attributable to taxable supplies.**

(2.5 marks)

(iii) **Incidental exempt financial supply does not apply to taxable persons who are in certain businesses. Name five (5) such businesses.**

(2.5 marks)

(b) A person who is late in applying for registration will be liable to pay a late registration penalty from the date he should have been registered to the date immediately before the date he is so registered, and this period is referred to as the late registration period under Section 21(6) of the GST Act 2014. Assuming Janen Sdn Bhd has exceeded the required threshold amount for GST registration on 18 January 2017 and applied for GST registration on 12 October 2017.

(i) **Explain the requirements for mandatory registration under Section 20 of the GST Act 2014.**

(3 marks)

(ii) **Compute the amount of late payment penalty amount.**

(3 marks)

(c) Group registration is a facility that allows two or more related companies to register as a group for GST purposes if they satisfy the conditions.

(i) **State the three (3) conditions for group registration.**

(4.5 marks)

(ii) **Assuming Company A has direct control (75%) over Company B and Company B has direct control (60%) over Company C. Explain with reasons whether Companies A, B and C can register as a group for GST registration purpose?**

(3 marks)

[Total: 20 marks]

Question 2

(a) Ravi Manufacturing Sdn Bhd ('the Company') is a resident company fully owned by Malaysians carrying on the business of manufacturing precision surgical equipment. The company has a paid up capital of RM7 million.

In early 2012 the Company undertook a qualifying expansion project under Schedule 7A of the ITA. Qualifying capital expenditures were incurred during the years of assessment 2013 to 2016.

Reinvestment allowance under Schedule 7A was claimed and fully off-set against the business statutory income of the respective years of assessment. The qualifying capital expenditures incurred were as follows:

YA	Qualifying capital expenditure incurred
2013	675,000
2014	1,012,500
2015	1,350,000
2016	1,012,500

The Company's director, Mr. Ravi is a charitable person. He regularly donates surgical and related instruments from the Company's stocks to charitable hospitals, free of charge at his own discretion. However, these instruments that were donated were not properly recorded and usually at the end of the financial year, any stock discrepancies are written off in the profit and loss account by the Company's accountant with the consent of Mr. Ravi.

One of the Company's clients was a large private hospital which owed a sum of RM300,000.

The client company undertook a management restructuring exercise in late 2014. A new finance manager was appointed, and upon taking over his duties, he refused authorization of the payment of the debt of RM300,000 to the Company citing some documentary discrepancy. The Company then wrote off the debt in the 2014 accounts to avoid any legal problems and loss of goodwill with the client.

Later, in 2016 the finance manager was sacked and a new person was appointed in his place, who happened to be an old friend of Mr. Ravi. The issue of the bad debts was taken up with him and after an accounting review, the payment of RM300,000 was fully paid, and the Company credited this amount in the accounts for the financial year end 2016.

The Company's books were audited by the Inland Revenue Board ('the IRB') in early 2017 for the years of assessment 2013-2016 and the IRB was of the view that:

i. The claim of reinvestment allowance is disputable. Accordingly, the claim of the reinvestment allowance for years of assessment 2013-2016 was disallowed.

ii. The donation of the surgical instruments to charitable hospitals should not have been claimed. The amount 'donated' is to be treated as stock withdrawal. As the records were inadequate, the IRB estimated that the amount of stock withdrawn amounting to RM10,000 for each of the relevant years of assessments, was reasonable.

iii. The bad debts claimed for the year of assessment 2014 was disallowed as there were, according to the IRB, no proper 'procedures' followed in writing it off, and its failure to institute legal action on the debtors to recover the outstanding debt.

The IRB wanted to re-compute the chargeable income of the Company and impose a 45% penalty on the additional taxes raised. The original chargeable income as per the tax returns submitted for the relevant years of assessment 2013-2016, and the original tax paid for those said years of assessment are as follows:

Year of assessment	**YA2013**	**YA2014**	**YA2015**	**YA2016**
Chargeable income	5,159,000	4,690,000	3,752,000	2,881,000
Original tax paid	1,289,750.00	1,172,500.00	938,000.00	720,250.00

Required:

Prepare a computation to show the adjustments the IRB will do in respect of the claim for reinvestment allowance; the stock withdrawal and the bad debts claim; the determination of the additional tax and the additional tax liability after the imposition of the 45% penalty.

Note:
Assume an income tax rate of 25% on the chargeable income for the years of assessment 2013-2016.

(12 marks)

(b) Mr. Chua is a qualified accountant and manages his own tax compliance and consultancy services in Kajang. He is a very careful and responsible person and relies on several of his senior staff to ensure that the information provided to the Inland Revenue Board is complete and accurate.

During the tax filing period for the year 2014, one Mr. Kong, a long-time friend of Mr. Chua, who runs an agency business enquired whether any incentive was available for engaging a physically disabled staff, who can perform desk based office work. Mr. Chua advised him that a double deduction is available for the remuneration paid to such an employee. At the time the tax return was filed for Mr. Kong, Mr. Chua had a standing instruction to all his staff that all information supplied by the client should be double checked and verified for accuracy and correctness. Mr. Leong, the Tax Senior who prepared the return for Mr. Kong had messaged him to enquire and confirm whether the particular staff is still in his employment.

In 2017, the Inland Revenue Board officers audited Mr. Kong's business and found that the claim for a double deduction for the remuneration paid to the particular staff was erroneous. The particular staff member was merely limping slightly due to an old injury but was otherwise of sound body and mind. There was no certificate from the relevant authorities to state that the staff member was in any way a physically handicapped person.

Required:

With reference to the ITA:

Discuss whether Mr. Chua could be charged with any offence with respect to the filing of Mr. Kong's tax return for the year of assessment 2014.

(2 marks)

(c) **Explain briefly THREE (3) methods commonly employed by IRB to detect any undisclosed income by taxpayers. The candidates are to express an opinion on the reliability of the methods employed by the IRB.**

(6 marks)

[Total: 20 marks]

Question 3

(a) M Bhd, is listed on Bursa Malaysia. M Bhd owns directly 100% of all five companies, namely P Sdn Bhd, Q Sdn Bhd, R Sdn Bhd, S Sdn Bhd and N Co. N Co is a company incorporated in Bermuda but for many years it has been a tax resident in Malaysia and has a profitable business based in Kuala Lumpur. P Sdn Bhd, Q Sdn Bhd, R Sdn Bhd, S Sdn Bhd and N Co all have 31 December year ends and have been members of the M Bhd group for more than 10 years.

(i) Mr. T, the Tax Director at M Bhd, informs you that P Sdn Bhd is planning to buy B Co, a company incorporated in Singapore from a third party. B Co owns land in Johor. P Sdn Bhd will fund the acquisition from its cash reserves.

Required:

Advise Mr. T on any direct tax issues (including relevant stamp duty) for P Sdn Bhd.

(5 marks)

(ii) Mr. T sent you an email stating that in the year to 31 December 2017, S Sdn Bhd has incurred a significant tax loss while N Co has chargeable income from its profitable business.

Required:

Advise Mr. T on the action required to surrender S Sdn Bhd's tax loss to N Co.

(2 marks)

(b) Q Sdn Bhd has a manufacturing business. Mr. T tells you that Q Sdn Bhd is planning to transfer its manufacturing business (together with employees) to M Bhd. Q Sdn Bhd's business consists of a factory, plant and machinery and inventory. After the transfer, Q Sdn Bhd will have no other business.

Required:

(i) **Advise Mr. T on the direct tax implications (excluding stamp duty) for Q Sdn Bhd and M Bhd on the transfer of Q Sdn Bhd's business.**

(7 marks)

(ii) **Advise Mr. T on the Goods and Services Tax implications of the transfer of the business for Q Sdn Bhd and M Bhd.**

(3 marks)

(c) A few days later, Mr. T calls you and asks you to comment on whether the transfer of Q Sdn Bhd's business to M Bhd would attract stamp duty under the Stamp Duty Act 1949 (as amended) and if so whether any relief is available.

You are required to advise Mr. T.

(3 marks)

[Total: 20 marks]

Question 4

(a) Joycar Battery Manufacturing Sdn Bhd (JBMSB) is a public listed company in Malaysia. JBMSB's principal activity is manufacturing and trading of car batteries. JBMSB was incorporated in 1978. JBMSB owns a land with factory and warehouse for its battery production and storage. Its clientele covers wholesalers, distributors and end consumers. For the last 10 years JBMSB had been exporting its car batteries to overseas markets.

Three years ago, JBMSB formed two subsidiary companies i.e. Joycar Battery Singapore Pte Ltd (JBSPL) and Joycar Battery Germany Co (JBG) with 100% direct shareholding. The functions of the foreign subsidiaries were to handle JBMSB's overseas market, i.e. generating the sales, handling customer services, product warranty and collection.

JBMSB owned all patents, licences and trademarks (IP) for the manufacturing process and for the production of batteries. Besides that, JBMSB centralised certain functions of the Group, which included procurement, logistics, human resources, treasury and technical support.

Below is an extract of JBMSB's financial statement for the year ended 31 March 2018, in relation to the related party transactions:

	RM
Sales of car batteries to JBSPL	50,000,500
Sales of car batteries to JBG	87,000,350
Management fees receivable from JBSPL	850,000
Management fees receivable from JBG	1,250,000

Required:

(i) **Define the terms "arm's length principle" and "related party" in the context of transfer pricing tax provisions.**

(2 marks)

(ii) **State JBMSB's related party transactions for the year ended 31 March 2018.**

(2 marks)

(b) In determining an arm's length transfer price, a functional analysis is often carried out to determine how a company carries out its functions, the assets held and the risks faced by the business.

Explain the functions, assets utilised and risk undertaken by JBMSB.

(5 marks)

(c) Characterization is an important element in the steps towards determining the arm's length price of a controlled transaction**.**

Based on the functions, assets utilised and risk undertaken, how would you characterise the operations of each entity in the Group?

(3 marks)

(d) There are five main OECD methods for transfer pricing, i.e. Comparable Uncontrolled Price (CUP), Cost Plus, Resale Price, Transactional Net Margin Method (TNMM) and the Profit Split Method. Taxpayers must apply an appropriate method for their particular case.

What would be the appropriate transfer pricing method to be applied on the above related party transactions identified under (a)?

Support your answer with reasons. **(6 marks)**

(e) **List any two external factors that you should consider when conducting a transfer pricing study on a cross border transaction.**

(2 marks)

[Total: 20 marks]

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Question 5

Venture capital is financial capital provided by individuals or companies to high potential and high risk companies at the early stages of the business. In order to encourage venture capital activities in Malaysia and to support the venture companies, the Malaysian Government has announced a number of incentives for the industry.

Required:

(a) A venture capital company (VCC) was established in 2015. In 2017 the VCC made its first investment and invested 80% of its invested funds in a start-up venture company (VC). The VC was involved in genetic engineering and was listed as a technology-based business activity. Both the VCC and the VC are not related companies. The financial accounting period of the VCC ends on 31 December each year. The VCC obtained a certification from the securities commission confirming that it had invested at least 70% of its invested funds in the VC for the year ending 31 December 2017.

Discuss the tax exemption incentive applicable to the VCC.

(6 marks)

(b) Mark is a retiree invested into ABC Sdn Bhd, a venture company. Mark took up a 5% ordinary share investment worth RM1 million in ABC Sdn Bhd. When ABC Sdn Bhd went into listing, Mark disposed of all his investment in ABC Sdn Bhd for RM2.5 million. Mark has no other income or investments other than his pension income.

Discuss the income tax implications from Mark's perspective under the ITA.

(6 marks)

(c) XYZ Sdn Bhd invested 20% on the ordinary share capital of ABC Sdn Bhd which amounted to RM5 million on 1 March 2015. XYZ Sdn Bhd on 1 November 2015 increased its investment in ABC Sdn Bhd in the form of early stage financing by RM2 million. When ABC Sdn Bhd went into listing on 1 April 2017, XYZ Sdn Bhd disposed its entire investment in ABC Sdn Bhd. XYZ obtained a certification from the Securities Commission that the investment in ABC Sdn Bhd qualified for the venture capital tax incentive.

Discuss the income tax implications on the disposal of investment by XYZ Sdn Bhd.

(6 marks)

(d) Venture Bhd, a venture capital company enjoying a tax exemption under Income Tax (Exemption) (No. 11) Order 2005, took up 5% ordinary share capital in ABC Sdn Bhd for an amount of RM1 million.

Discuss whether Venture Bhd is allowed to claim deduction on the cost of investment in ABC Sdn Bhd.

(2 marks)

[Total: 20 marks]

Question 6

Salvation Sdn Bhd (SSB) is planning to acquire a new heavy machine in July 2018 which is estimated to cost the company RM480,000. As it does not have adequate funds, SSB is considering the options to either seek a term loan (Loan Option) or to finance it through a hire-purchase (HP Option). For either options, it would involve **an eight**-year repayment period. SSB is enjoying pioneer status tax incentive (100% exemption), where its pioneer period is ending on 31 December 2019. SSB has a 31 December financial year end.

Required:

Explain the tax implications under the ITA in respect of both the (i) Loan option and (ii) Hire purchase option on the:

(a) Claim of capital allowances.

(Provide supporting computation of capital allowances for years of assessment 2018 and 2019)

(10 marks)

(b) Treatment of interest expenses, including possibility of interest restriction that is to be imposed.

(4 marks)

(c) Tax efficiency in consideration of its pioneer status incentive.

(Assume that the financing costs for both options are the same)

(6 marks)

[Total: 20 marks]

(END OF QUESTION PAPER)