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

PROFESSIONAL EXAMINATIONS

FINAL LEVEL

REVENUE LAW

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 <u>FIVE</u> 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. Answers should be written in either black or blue ink.

6. No question paper or answer booklet is to be removed from the examination hall.

DO NOT TURN OVER THIS PAGE UNTIL INSTRUCTED BY THE INVIGILATOR

Question 1

Sing Co Pte Ltd (SCPT) is a company incorporated on 3 January 2017 in Singapore. It has six directors and four of them are Malaysian citizens who are residing in Johor Bharu. SCPT's core business is to conduct motivation programmes for corporations in the region, including Malaysia. Board meetings of the company are held both in Singapore and Johor Bharu though the company does not have an office in Malaysia. The last annual general meeting of the company was held in Singapore. The company is concerned of its tax resident status for Malaysian tax purposes and seeks your advice.

Required:

Advise the company on the following issues raised by the managing director of the company who resides in Singapore.

(a) Is SCPT, a company incorporated outside Malaysia, a tax resident in Malaysia in the basis year 2017? If so, how is the residence status of a company determined under the ITA?

(4 marks)

(b) What are the tax implications on the company and/or tax benefits the company may be entitled to if it is deemed to be a tax resident in Malaysia?

(4 marks)

(c) With reference to case law authorities, identify and discuss the factors to be considered in the determination of corporate tax residence based on the facts given.

(12 marks)

Note:
Ignore the provisions for the avoidance of double taxation agreements in answering the above.

[Total: 20 marks]

Question 2

Pro Knit Sdn Bhd (ProKnit) was incorporated in Malaysia and is a Malaysian tax resident. The company has been in the business of manufacturing garments since the year of assessment (YA) 2010, and closes its accounts on 31 December each year.

For the entire YA 2017, ProKnit subcontracted its production operations (i.e. cutting and sewing of garments) to its non-resident subsidiary in Cambodia (C-Fab). The production operations were routine in nature and did not require considerable technical skills.

Upon receiving the garments from C-Fab, ProKnit packs the garments in its factory in Malaysia by using a machine leased from a vendor in Brazil (Barbell Br.). Barbell Br. is the Brazilian branch of a United Kingdom company, which does not have a permanent establishment in Malaysia. Under the lease agreement, a monthly lease payment has been specified. However, for accounting purposes, the lease is classified as a finance lease and has a separate "principal" and "interest" repayments recorded in the income statement.

ProKnit also remits annual software license fees for the use of an accounting system, to a non-Malaysian resident vendor. The vendor Tech Co, is a tax resident company in Singapore and does not have a permanent establishment in Malaysia. The systems are wholly maintained in Singapore.

In future, ProKnit will license software from Silicon Valley Co, a tax resident of the United States. In addition to licensing software from Silicon Valley Co, ProKnit also intends to acquire software from Silicon Valley Co.

ProKnit also pays a management fee to its holding company (P-Holding Ltd) in Singapore. All management services are rendered outside Malaysia.

The chief financial officer (CFO) of ProKnit has approached you, the company's tax adviser, on whether the payments to C-Fab, P-Holding Ltd, Barbell Br., Tech Co and Silicon Valley Co are subject to withholding tax for YA 2017.

Required:

With reference to the ITA, the double tax agreements (DTA) and relevant case law authorities:

(a) Advise the CFO whether the payments to C-Fab and P-Holding Ltd are subject to withholding tax and if so, at what rate(s).

(7 marks)

(b) Advise the CFO whether the payments to Barbell Br. are subject to withholding tax and if so, at what rate(s).

(6 marks)

(c) Advise the CFO whether the payments to Tech Co are subject to withholding tax. How would the position differ if payments (for both software licence and software acquisition) are made to Silicon Valley Co?

(7 marks)

Note: Extract of relevant DTA articles are provided

[Total: 20 marks]

Extract of Article 5 & 7- DTA Malaysia UK

Article 5
PERMANENT ESTABLISHMENT

1. *For the purposes of this Agreement, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.*

2. *The term "permanent establishment" includes especially:*

   (a) a place of management;
   (b) a branch;
   (c) an office;
   (d) a factory;
   (e) a workshop;
   (f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources including timber or other forest produce;
   (g) a farm or plantation;
   (h) a building site or construction, installation or assembly project which exists for more than six months.

3. *Notwithstanding the preceding provisions of this Article, the term "permanent establishment" shall be deemed not to include:*

   (a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;
   (b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;
   (c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
   (d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or of collecting information, for the enterprise;
   (e) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character;

4. *The maintenance of a fixed place of business solely for any combination of activities mentioned in sub-paragraphs (a) to (e) of this paragraph, provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character. An enterprise of a Contracting State shall be deemed to have a permanent establishment in the other Contracting State if it carries on supervisory activities in that other State for more than six months in connection with a construction, installation or assembly project which is being undertaken in that other State.*

5. *A person (other than a broker, general commission agent or any other agent of an independent status to whom paragraph 6 applies) acting in a Contracting State on behalf of an enterprise of the other Contracting State shall be deemed to be a permanent establishment in the first-mentioned State, if:*

   (a) he has, and habitually exercises in the first-mentioned State, an authority to conclude contracts in the name of the enterprise, unless his activities are limited to the purchase of goods or merchandise for the enterprise; or
   (b) he maintains in the first-mentioned State a stock of goods or merchandise belonging to the enterprise from which he regularly fills orders on behalf of the enterprise.

6. *An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent or any other agent of an independent status, where such persons are acting in the ordinary course of their business.*

7. *The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.*

Article 7
BUSINESS PROFITS

1. *The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much thereof as is attributable to that permanent establishment.*

2. *Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.*

3. *In determining the profits of a permanent establishment, there shall be allowed as deductions expenses, including executive and general administrative expenses which would be deductible if the permanent establishment were an independent enterprise insofar as they are reasonably allocable to the permanent establishment, whether incurred in the State in which the permanent establishment is situated or elsewhere.*

4. *No profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.*

5. *Where the profits include items of income which are dealt with separately in other Articles of this Agreement, then the provisions of those Articles shall not be affected by the provisions of this Article.*

Extract of Article 12 & 13 – DTA Malaysia Singapore

Article 12
ROYALTIES

1. *Royalties arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.*

2. *However, such royalties may also be taxed in the Contracting State in which they arise and according to the laws of that State, but if the beneficial owner of the royalties is a resident of the other Contracting State, the tax so charged shall not exceed 8 per cent of the gross amount of the royalties.*

3. *The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work (including cinematograph films, and films or tapes for radio or television broadcasting), any patent, trade mark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment, or for information (know-how) concerning industrial, commercial or scientific experience.*

4. *The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the royalties, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties arise, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the royalties are paid is effectively connected with such permanent establishment or fixed base. In such case, the provisions of Article 7 or Article 14, as the case may be, shall apply.*

5. *Royalties shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying such royalties, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the obligation to pay the royalties was incurred, and such royalties are borne by such permanent establishment or fixed base, then such be deemed to arise in the State in which the permanent establishment or fixed base is situated.*

6. *Where, by reason of a special relationship between the payer and the beneficial owner both of them and some other person, the amount of the royalties paid, having regard to the use, right or information for which they are paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such a case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Agreement.*

Article 13
TECHNICAL FEES

1. *Technical fees derived from one of the Contracting States by a resident of the other Contracting State who is the beneficial owner thereof may be taxed in the first- mentioned Contracting State. However, the tax so charged shall not exceed 5 percent of the gross amount of the technical fees.*

2. *The term "technical fees" as used in this Article means payments of any kind to any person, other than to an employee of the person making the payments, in consideration for any services of a technical, managerial or consultancy nature.*

3. *The provisions of paragraph 1 shall not apply if the beneficial owner of the technical fees, being a resident of a Contracting State, carries on business in the other Contracting State in which the technical fees arise, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the technical fees are effectively connected with such permanent establishment or fixed base. In such case, the provisions of Article 7 or Article 14, as the case may be, shall apply.*

4. *Technical fees shall be deemed to arise in a Contracting State when the payer is a resident of that State and the services are performed in that State. Where, however, the person paying the technical fees, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the obligation to pay the technical fees was incurred, and such technical fees are borne by such permanent establishment or fixed base, then such technical fees shall be deemed to arise in the Contracting State in which the permanent establishment or fixed base is situated if the services are performed in that State.*

5. *Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the technical fees paid exceeds, for whatever reason, the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last mentioned amount. In such case, the excess part of the payments shall remain taxable according to the law of each Contracting State, due regard being had to the other provisions of this Agreement.*

Question 3

(a) Amongst others, the following tests have been formulated by the courts in distinguishing between capital expenditure and revenue expenditure:-

(i) The business structure or process test

(ii) The fixed or circulating capital test

(iii) The identifiable asset test

Required:

Based on the above tests, what is/are the key element(s) or factor(s) that determine an expense is a capital expenditure?

(6 marks)

(b) XY Sdn Bhd has been in business for many years as a distribution company. As part of the business expansion plans, it started a new line of business by hiring out advertising space on its trucks. XY Sdn Bhd incurred fees of RM200,000 in getting the new business started.

Required:

State whether the expenditure is capital or revenue in nature with reference to relevant case law authorities.

(8 marks)

(c) TC Sdn Bhd intends to set up a training center for its staff and it is expected to incur the following costs:

(i) Renovation costs;

(ii) New IT equipment;

(iii) Payment to recruitment agency to hire appropriate training staff;

(iv) Relocation costs on the hiring of expatriates to relocate to Malaysia;

(v) Consultancy services for design of training course outline and content; and

(vi) Upfront payment for 12 months catering services.

It should be noted that the training centre is related to the current business of TC Sdn Bhd.

Required:

Comment on the deductibility of the above costs based on the relevant provisions of the ITA.

(6 marks)

[Total: 20 marks]

Question 4

Capital Sdn Bhd ("Capital") was incorporated in year 2008 and is in the business of property investment and property holding.

In year 2009, it purchased a plot of land at Jalan Ampang and disposed of the same in 2012. The said plot of land was held as an investment and accordingly, the gains on disposal were subject to real property gains tax.

In year 2013, Capital used the proceeds from the sale of the said land to purchase another plot of land at Jalan Bukit Bintang. It was recorded in Capital's Directors' Resolution and minutes of Board meeting that this plot of land was purchased for investment purposes and will be held for the long term. In addition, the said land was consistently treated as a "fixed asset" in Capital's audited accounts.

In year 2014, Capital entered into talks with Prolific Sdn Bhd, a reputable property developer in town. The talks were essentially relating to the joint development of Capital's land at Jalan Bukit Bintang. During the said talks, it was their common intention that Capital shall supply the land whereas Prolific Sdn Bhd shall play the role of the developer of the said land.

At around the same time, Prolific engaged an architect to commence drawing plans for the purposes of the development of 3 blocks of serviced apartments on the said land. Prolific also wrote a preliminary application to the Land Office and local authorities to apply for a development order.

Nevertheless, the development plan did not materialise as Capital and Prolific Sdn Bhd's negotiations stalled. Prolific also withdrew its application for the development order in 2015.

During the tenure of ownership, Capital did some minor upkeep to the land, such as clearing the grass and ensuring that the drainage system was working properly. Other than that, Capital did not alter the land in any manner.

In year 2016, Capital disposed the land on Jalan Bukit Bintang to another company i.e. Investors Sdn Bhd. Investors Sdn Bhd approached Capital for the purpose of purchasing the said land. At all material times, Capital did not advertise the sale of the land. In doing so, Capital earned RM 5,000,000 in gains from the sale of the land.

Required:

Advise with reasons and reference to relevant case law authorities, whether the gains arising from the disposal of the land at Jalan Bukit Bintang is subjected to income tax or real property gains tax.

[Total: 20 marks]

Question 5

(a) In Year of Assessment 2016, Company A had made a cash donation to Yayasan XYZ, an organisation approved under section 44(6) of the ITA. However, in filing its returns for YA 2016, it forgot to take into consideration the donations it made to Yayasan XYZ. In March, 2018, it realised its mistake and approached you for advice on how to make an application to rectify its mistake and make a claim for the donation it made.

Required:

Based on provisions of the ITA and relevant case law authorities:

(i) Advise Company A on the best approach to rectify its mistake.

(4 marks)

(ii) Advise Company A on how the Director General of Inland Revenue is likely to consider the application.

(5 marks)

(iii) In the event Company A's application is rejected by the Director General of Inland Revenue, advise Company A on its next steps as well as the likely sequence of events.

(3 marks)

(b) RST Sdn Bhd was audited by the Inland Revenue Board of Malaysia ("IRBM") in January 2017. Pursuant to the audit, the IRBM discovered that RST Sdn Bhd had filed incorrect returns for the years of assessments 2013 and 2014 and therefore raised notices of additional assessments pursuant to section 91(1) of the ITA against RST Sdn Bhd for the additional amount of tax including penalty under section 113(2) of the ITA on 17 July, 2017.

RST Sdn Bhd failed to settle the additional tax and penalty owing under the notices of additional assessments within the prescribed time period. RST Sdn Bhd is now concerned about the possible actions that may be taken by the IRBM against RST Sdn Bhd.

Required:

(i) Advise RST Sdn Bhd about the possible consequences of not settling the tax and penalty owing under the notices of additional assessments within the prescribed time period.

(4 marks)

(ii) Adam is a director of RST Sdn Bhd and owns 51% of the ordinary shareholding of RST Sdn Bhd. He is due to travel to Hong Kong in a couple of weeks' time and is concerned about the non-payment of the outstanding tax and penalty. He however mentioned that he is not leaving the country permanently and will only be abroad for about a month.

Based on provisions of the ITA and case law authorities:

Advise Adam on the possible actions that may be taken by the IRBM against him as a director of RST Sdn Bhd.

(4 marks)

[Total: 20 marks]

Question 6

Rococos Sdn Bhd ("Rococos") is a company incorporated on 1 January 2014. Since 2 March 2014, Rococos is in the business of manufacturing rubber linings for automobiles. For the production of these rubber linings, Rococos incurred expenditure on plant and machinery to produce the rubber linings in its factory in Kulai, Johor.

Required:

(a) Advise Rococos on the requirements that it needed to fulfil to claim capital allowance pursuant to Schedule 3 of the ITA in respect of the capital expenditure it incurred on its plant and machinery and whether there are any tests to determine what amounts to "plant"?

Rococos also sought your advice on whether it could still claim capital allowance on the plant and machinery if it remains as the owner but hires sub-contractors to operate its plant and machinery.

(10 marks)

On 6.7.2017, Rococos decided to produce tyres for commercial vehicles and glass laboratory equipment as the demand for the automobile rubber linings was low and the profit margin was slim. In this regard, Rococos incurred capital expenditure for plant and machinery to produce both the products**.**

Required:

(b) Advise Rococos on what is reinvestment allowance and whether it will be eligible for reinvestment allowance claim for both the products?

(8 marks)

Further, Rococos decided to make an application to produce rubber tyres for commercial vehicles. With effect from 1 April 2018, Rococos was granted a pioneer certificate for the production of promoted products, namely rubber casings for car interiors and tax exemption restricted to 70% statutory income for 5 years. Taking into account your answer at (b) above:

Required:

(c) Advise Rococos whether it will be eligible for pioneer relief.

(2 marks)

[Total: 20 marks]

(END OF QUESTION PAPER)