



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

PROFESSIONAL EXAMINATIONS

FINAL LEVEL

ADVANCED TAXATION 2

JUNE 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 order to complement the regional principal hub structure which has been widely adopted by multinational companies, the Government introduced the Principal Hub incentives with effect from 1 May 2015. This customised tax incentive offered both fiscal and non-fiscal benefits to the multinational companies while enabling Malaysia to move up the global value chain.

Required:

- (i) **State five (5) eligibility criteria to qualify for the Principal Hub tax incentive.**
(5 marks)
- (ii) The fiscal benefits granted to an approved Principal Hub company varies according to the category of company.

Discuss the tax incentive available for the following categories:

- a. **Newly incorporated company;**
(4 marks)
- b. **Existing Manufacturing / Service Company.**
(3 marks)

- (iii) **Explain the procedure by which the Principal Hub incentive will be granted.**
(4 marks)

- (b) BFuel AG (BFuel) is a multinational group of companies based in Germany. BFuel produces ethanol and biodiesel in its 200 over plants across the world. To optimise resources and quicken decision making for its Asia Pacific region, BFuel incorporated a wholly-owned company, BFuel-M Sdn Bhd (BFuel-M), in Malaysia on 1 July 2018 with a paid-up capital of RM10 million. BFuel-M provided the following activities to its related companies in Cambodia, Vietnam and Thailand:

- i. Strategic business planning;
- ii. Brand management;
- iii. Strategic sourcing; and
- iv. Logistic services.

To perform the above activities, BFuel-M brought in 15 expatriate employees from its headquarters in Germany. BFuel-M is expected to achieve RM350 million sales in its first year of operation.

- Explain with reasons whether BFuel-M qualifies for Principal Hub incentive.**
(4 marks)

[Total: 20 marks]

Question 2

- (a) Taxpayers with the assistance of tax consultants and legal practitioners may embark on tax avoidance schemes so long as they are permissible in the Income Tax Act, 1967 and are sanctioned by the courts.

Distinguish between tax avoidance and tax planning under the ITA by giving an example to illustrate the difference.

(10 marks)

- (b) XYZ Sdn Bhd (XYZ) is a property development company. Accordingly, the profits attributed to the company were regarded as business income and were subjected to income tax under the ITA.

During the years, XYZ identified a few plots of land as being appropriate for long term investment, where it can build shop houses and a shopping complex with the aim of leasing out some of the shop houses. XYZ expects gains from this investment. However, as a property development company, the projected gains will be subjected to income tax.

After seeking the tax advice from a tax firm to minimize the tax exposure, XYZ formed a wholly owned subsidiary and joint ventured with XYZ to develop the project. The subsidiary was formed as an investment holding company to undertake the project. However, the subsidiary relied heavily on XYZ. As a subsidiary it had no expertise or funds to develop the project.

After the project was completed, the subsidiary leased out the shop houses and the shopping complex for a relative long period, about five years, before it sold off the shop houses and the shopping mall. As a realization of investment, the subsidiary subjected the gain (or loss) from the disposal of investment properties to real property gains tax.

Thereafter, XYZ sold the shares of the subsidiary to a related company. Ultimately, the subsidiary and the related company were wound up.

Required:

Based on the above scenario, do you think XYZ was undertaking a tax avoidance scheme? Briefly explain the reasons for arriving at your answer.

(10 marks)

[Total: 20 marks]

Question 3

A tax audit is an examination of tax return by the Inland Revenue Board of Malaysia (IRBM) to examine your tax return a little more closely and verify that your income and deductions are accurate. There are two types of tax audits which are desk audit and field audit.

Required:

- (i) Explain the difference between desk audit and field audit as mentioned above.**

(6 marks)
- (ii) List down six (6) types of documentation that is expected to be furnished by taxpayers during tax audit.**

(2 marks)
- (iii) Describe the processes of a tax audit carried out by IRBM from commencement till closure and settlement of the audit findings.**

(8 marks)
- (iv) Discuss the offences and penalties and applicable sections in the Income Tax Act, 1967 on understatement or omission of income.**

(4 marks)

[Total: 20 marks]

Question 4

- (a) The Inland Revenue Board, Malaysia (IRBM) prefers the arm's length approach in determining the transfer price of a transaction between associated persons.

Required:

Explain the application of the arm's length principle.

(3 marks)

- (b) The IRBM normally allows arm's length range of prices if the chosen transfer pricing method by taxpayer falls within the "range".

Required:

Explain what is meant by arm's length price range and how the IRBM may adjust the transfer price selected by the taxpayer.

(7 marks)

- (c) S, a controlled subsidiary in Malaysia, sells switches as components for use in the electronics industry to P, its US parent corporation. P affixes its trademark to the switches and markets the switches in the United States at USD14 each. The addition the trademark has a significant effect on the resale price of the switches. The average cost of producing a switch is USD8. Several unrelated manufacturers performing functions similar to manufacturing of switches obtain a gross mark-up of 25 percent above the cost of production.

Required:

- (i) **State which transfer pricing method should P use that is deemed to be the most appropriate to determine the arm's length price on its purchase of switches from S, and**

- (ii) **Compute the arm's length price and gross profit.**

(4 marks)

- (d) **Explain the transfer pricing method used and how the selections of comparable data are made to arrive at the gross profit margin.**

(6 marks)

[Total: 20 marks]

Question 5

(a) Article 5 on Permanent Establishment states that an enterprise of a residence state can create a permanent establishment (PE) in another state through three (3) types of business activities, i.e. (i) Asset-type PE, (ii) Construction type PE and (iii) Agency PE.

(i) **Define how the Asset-type PE is created and the conditions that must be satisfied in order to constitute a PE under this rule.**

(6 marks)

(ii) **Types of assets that would prima facie constitute a PE.**

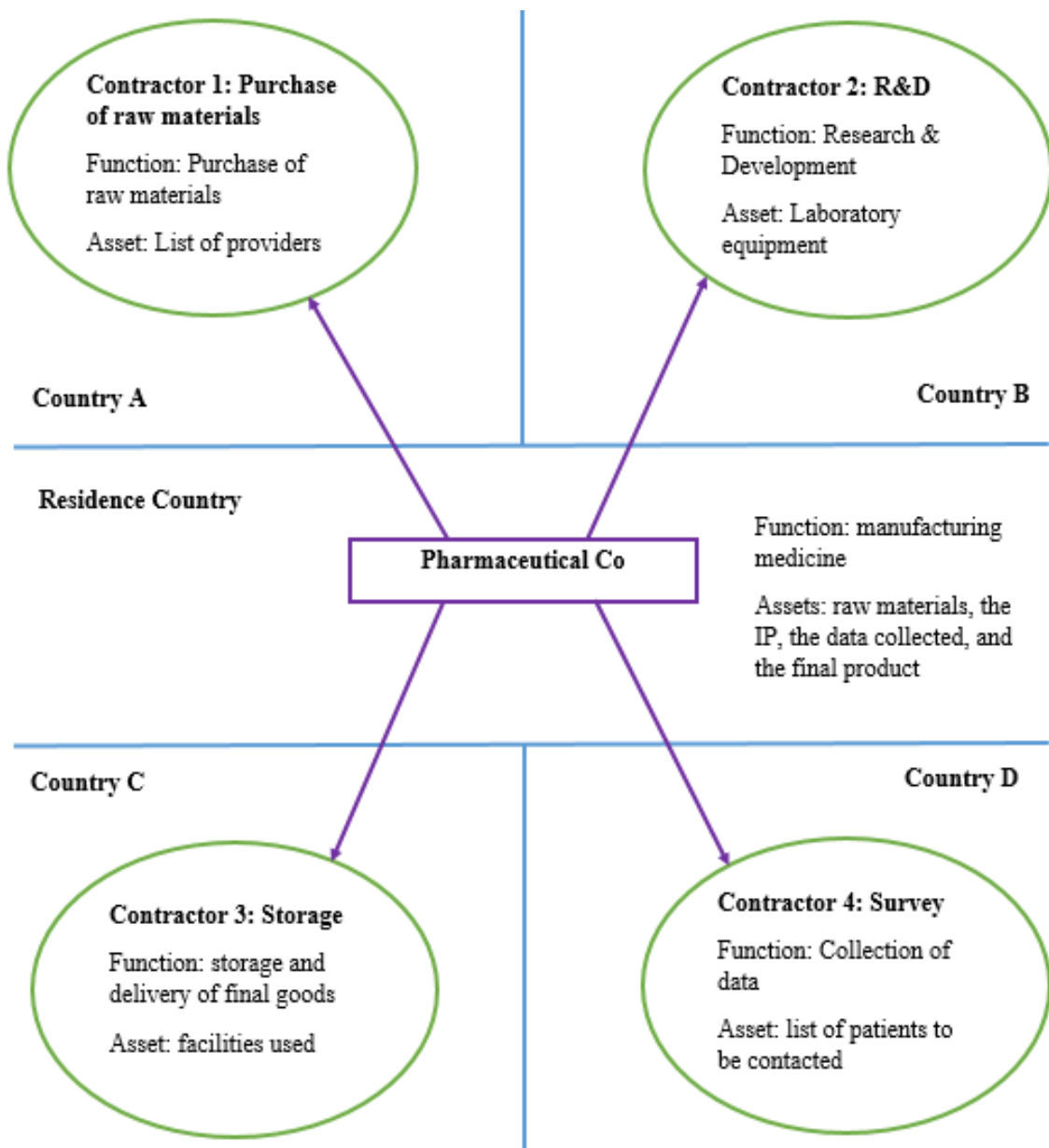
(2 marks)

(b) Some business activities as stated under Article 5(4) do not constitute a PE even if they are performed through a fixed place of business.

Pharmaceutical Co is resident in Country *R* and operates in the pharmaceutical field. The manufacturing of medicines is performed in Country *R* by Pharmaceutical Co itself. The other processes are taken care of by different branches (contractors in the illustration) in four countries as follows:

- **Country A:** Contractor 1 is a branch responsible for purchasing raw materials such as plants used in the production of medicines to be sold by Pharmaceutical Co. The latter has a facility in Country *A* used for storing the purchased plants. The ownership of the raw material is at the level of the parent company in Country *R*.
- **Country B:** Contractor 2 is a branch running a laboratory that conducts research and development activities in Country *B*. Such activities led to developing intellectual property (IP) that the parent company (Pharmaceutical Co) owns. The know-how is used to manufacture the medicine in Country *R*.
- **Country C:** Contractor 3 is a branch responsible for storing and delivering the final products (medicines) destined to be sold worldwide.
- **Country D:** Pharmaceutical Co has a fixed place where an employee carries on surveys by interviewing patients about symptoms they show and side effects they experience after using the medicine manufactured by Pharmaceutical Co. In Country *D*, the only activity undertaken is the collection of data by completing the questionnaires. The employee responsible for the task collects and sends the raw information (the questionnaires) to be analysed in Country *R*.

The above transactions can be graphically represented as below:



Required:

State whether the activity performed by the contractors in each Country A, B, C and D in each of the cases above would constitute a PE in that country and explain your basis to support your argument.

(12 marks)

[Total: 20 marks]

Reference: UN Model Tax Convention

Article 5: PERMANENT ESTABLISHMENT

1. For the purposes of this Convention, 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;
 - g) Natural resources.
3. The term “permanent establishment” also encompasses:
 - a) A building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than six months;
 - b) The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than 183 days in any 12-month period commencing or ending in the fiscal year concerned.
4. 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 or display 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 or display;
 - 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.
 - f) The maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs (a) to (e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

5. Notwithstanding the provisions of paragraphs 1 and 2, where a person—other than an agent of an independent status to whom paragraph 7 applies—is acting in a Contracting State on behalf of an enterprise of the other Contracting State, that enterprise shall be deemed to have a permanent establishment in the first-mentioned Contracting State in respect of any activities which that person undertakes for the enterprise, if such a person:
 - a) Has and habitually exercises in that State an authority to conclude contracts in the name of the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph; or
 - b) Has no such authority, but habitually maintains in the first-mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise.
6. Notwithstanding the preceding provisions of this Article, an insurance enterprise of a Contracting State shall, except in regard to re-insurance, be deemed to have a permanent establishment in the other Contracting State if it collects premiums in the territory of that other State or insures risks situated therein through a person other than an agent of an independent status to whom paragraph 7 applies.
7. 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, provided that such persons are acting in the ordinary course of their business. However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise, and conditions are made or imposed between that enterprise and the agent in their commercial and financial relations which differ from those which would have been made between independent enterprises, he will not be considered an agent of an independent status within the meaning of this paragraph.
8. 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.

Question 6

Malaysia Baru Logistics Sdn Bhd ('MBL') is in the business of providing logistic services for both sea and air transport services. Since June 2018, MBL began operations in tandem with its related company, Denmark Logistics Limited ('DL'), a company incorporated and resident in Denmark, to handle the logistics in the Far East with regards to cargoes moving in this region. To assist with the local operations, DL allowed MBL the use of its proprietary software which is essentially an electronic data processing system (EDP) for use in MBL's logistics operations, but not exploit any of the intellectual property rights in the system. Payment for the use of the EDP is to be made quarterly to DL, and the first of such payments is due in September 2018. The quarterly payments will be in force so long as MBL continues to use the EDP under a contract arrangement.

DL does not have a permanent establishment in Malaysia; and the payments received from MBL are treated as its 'business income' on which income tax is paid in Denmark. The contract for the use of the EDP is signed for five years with effect from 1 June 2018.

The EDP charges are not defined as 'royalty' in the Malaysian double tax agreement with Denmark. **The newly appointed Financial Controller of MBL is a little uncertain about withholding tax matters and has written to you for advice.**

Required:

- (i) **Explain to the Financial Controller of MBL whether withholding tax should be deducted from the payment to DL for the use of the proprietary software.**

Note:

You should make reference to the ITA 1967 (as amended), Extract of the Double Taxation Agreement with Denmark provided below and the relevant case law authorities in drawing up your advice, explaining briefly the interpretive approaches to tax legislations.

(13 marks)

- (ii) **Would your answer in (i) above differ if the disbursement to DL is made in one single lump sum upfront payment?**

(7 marks)

[Total: 20 marks]

Extract of the Malaysia Denmark DTA is attached

DOUBLE TAXATION AGREEMENT (MALAYSIA – DENMARK)

Article XII

1. Royalties derived from one of the Contracting States by a resident of the other Contracting State who is subject to tax in that other Contracting State in respect thereof shall be exempt from tax in the first-mentioned Contracting State provided that such royalties are approved after the signature of this Agreement by the Government of the Contracting State from which they are derived.
2. The term "royalties" as used in this article means a payment of any kind received as consideration for the use of, or the right to use, any copyright, 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 concerning industrial, commercial or scientific experience but does not include any royalty or other amount paid in respect of literary or artistic copyrights or of motion picture films or of tapes for television or broadcasting or of the operations of a mine, oil well, quarry or other places of extraction of natural resources or of timber or forest produce.
3. Sums derived by a resident of one of the Contracting States from the other Contracting State the payment of which is approved after the signature of this Agreement by the Government of that other Contracting State, from the alienation of any right or property from which royalties (as defined in paragraph 2 of this article) are or may be derived, shall be exempt from tax in that other Contracting State.
4. The provisions of paragraphs 1 and 3 of this article shall not apply if the recipient of the royalties, or sums, being a resident of one of the Contracting States, has in the other Contracting State from which the royalties or sums are derived a permanent establishment with which the rights or property giving rise to the royalties is effectively connected. In such a case, the provisions of article VII shall apply.

(END OF QUESTION PAPER)