MINUTES OF THE DIALOGUE BETWEEN TECHNICAL DEPARTMENT OF THE INLAND REVENUE BOARD MALAYSIA AND ASSOCIATION OF ACCOUNTANTS HELD ON 15 MARCH 2006

Post Budget Issues Raised By the Association Of Accountants To The Technical Department Of The Inland Revenue Board Malaysia (IRBM)

A. 2006 BUDGET ISSUES

1. Tax Treatment on Losses and Unabsorbed Capital Allowances

Note by the IRBM:

Pleased be informed that the Honourable Ministry Of Finance (MOF) has decided that the procedure on the implementation of the tax treatment of brought forward losses and unabsorbed capital allowances is as follows:-

1. A company with a substantial change in ownership will be allowed to carry forward its accumulated losses and unabsorbed capital allowances if there is no substantial change of the ultimate shareholder.

For the purpose of confirmation that there is no substantial change of the ultimate shareholder, the following procedure will be used:-

Type of company	Confirmation of no substantial change of ultimate shareholder.
Public listed companies (PLC).	- External auditor of the PLC; or - Secretary of the PLC In the absence of the above, - Audit committee of the PLC; - Financial Controller of the PLC;or - Director of the PLC.
Non-public listed companies (non- PLC),	- A company incurring losses provides a list of the ultimate shareholder and proves that there is no substantial change of the ultimate shareholder; or Confirmation of no substantial change of the ultimate shareholder by: - External auditor of the company incurring losses;or - Secretary of the company incurring losses; or

	In the absence of the above:- **- Audit committee of the company incurring losses; or** **- Financial controller of the company incurring losses; or** **- Director of the company incurring losses.**

2. A company with a substantial change of the ultimate shareholder for commercial purposes and not for tax driven will be considered by MOF through his power under section 33(3) Finance Act 2006 if the substantial change is the result of the following activities:-

a. Privatisation of government owned company.
b. Nationalisation.
c. Government's directive on reorganisation, restructuring, mergers or takeover of a company.

In line with the MOF directives, some of the IRBM's response on the same issue are overtaken by event and therefore no responses should be minuted.

1.1 A continuity of ownership test of more than 50% in shareholdings is now proposed in order for accumulated losses and capital allowances to be carried forward. Such tests can be administered for non-listed companies.

The Institutes would like to seek clarification on the position to be taken in respect of public listed companies and the procedures to be used to monitor such changes in view of the difficulties in tracking shareholdings in listed companies.

Answer:

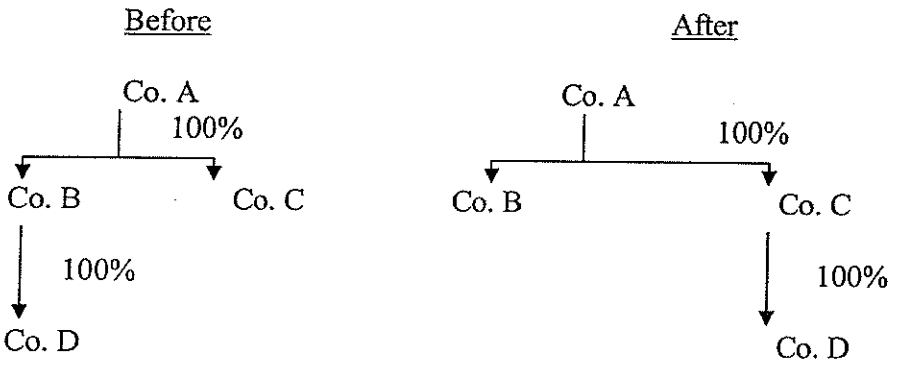
Refer to the above note.

1.2 The following subparagraph 5B(b) of Section 44 has been proposed in the Finance Bill 2005:-

"shares in the company held by or on behalf of another company shall be deemed to be held by the shareholders of the last mentioned company"

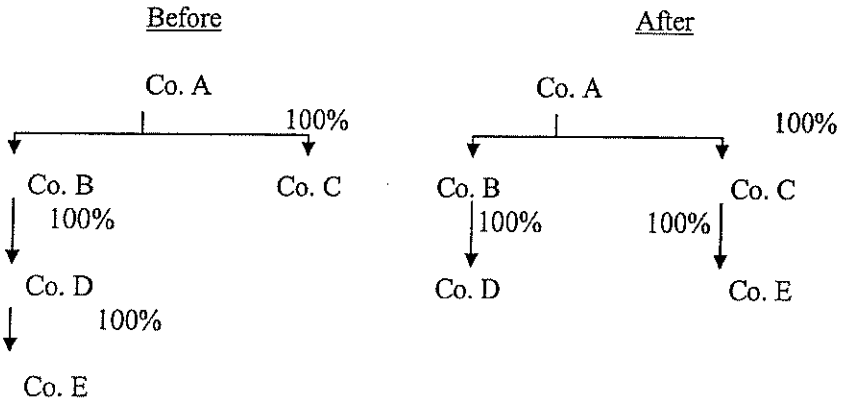
The Institutes would like to seek clarification on the above i.e. how many corporate tiers are to be examined and also confirmation relating to the following scenarios:

Scenario 1



Shares in Co. D held by or on behalf of Co. B shall be deemed to be held by the ultimate shareholder of Co. B (which is Co. A). Therefore, accumulated losses and unabsorbed capital allowances can be carried forward following the transfer of Co. D shares from Co. B to Co. C as there is no substantial change in shareholding of Co. D i.e. the ultimate holding company is still Co. A.

Scenario 2



The transfer of Co. E shares from Co. D to Co. C, does not alter the ultimately wholly owned company (i.e. Co. A). In view of the fact that the ultimate shareholder is the same, the provision should not be applied for such internal restructuring exercises.

The insertion of sub-sections 5A-5D to Section 44 of the Income Tax Act (the Act) has the effect of disregarding unabsorbed losses and capital allowances even in genuine cases of restructuring within a group of companies. This is due to the operation of Section 44(5B)(b) which states that shares in the (loss) company held by or on behalf of another company (i.e. shareholder of the loss company) shall be deemed to be held by the shareholders of the last mentioned company (i.e. shareholder of the loss company).

In Scenario 2 above, (assuming all companies are 100% owned), applying Section 44(5B)(b), the shareholders of the loss company i.e. Co. E, before the change in shareholding, are Co. D and Co. B, and after the change in shareholding, are Co. C and Co. A. The losses and capital allowances are

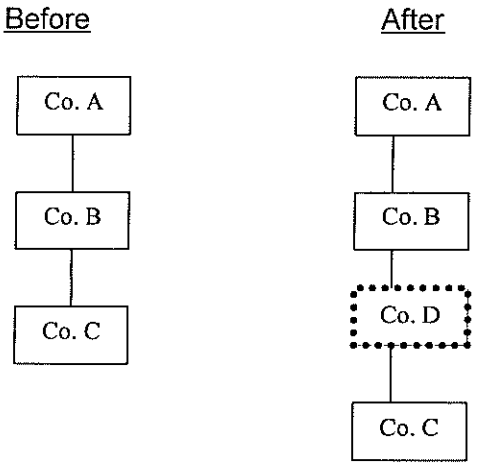
restricted notwithstanding the restructuring of Co. E within the Group of Companies.

Answer:

Refer to the above note.

1.3 The Institutes wish to reconfirm whether the proposed tax changes will be applied (in Scenario 3 below) to a company (Company C) where there is a change in its immediate holding company (from Company B to D) following an internal group restructuring to achieve efficiency within the group while the company concerned (Company C) is still owned by the same ultimate holding company (Company A) as illustrated below (in other words, will Company C be deemed to have a substantial change in its shareholding):

Scenario 3



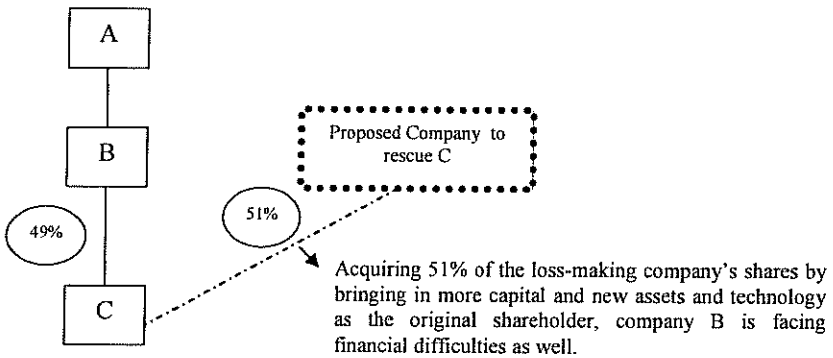
Answer:

Refer to the above note.

1.4 Sub-sections 5A-5D of Section 44 of the Act has the effect of curtailing internal restructuring of companies for group efficiency.

The Institutes are of the opinion that these provisions should not apply to situations of internal restructuring (as in Scenario 4 below) where the ultimate ownership of the shares after the transfer remains unchanged. The proposed legislation should only be applied to those exercises which seek to obtain a tax advantage by acquiring a loss-making company without valid commercial justification. However, it should not deter a genuine turn-around exercise to rescue a loss-making company as illustrated below:

Scenario 4



Answer:

Refer to the above note.

The Institutes also wish to seek confirmation of the following:

(i) whether the Minister of Finance will consider redrafting sub-sections 5A-5D in Section 44 to exclude genuine restructuring schemes such as those mentioned above?

(ii) will each case of genuine restructuring require the Minister to consider an application under Section 44(5D)?

(iii) whether the proposed legislation would be applied if there is a change in substantial shareholding during a pioneer period.

(iv) whether the IRB will issue any guidelines to explain and illustrate the various scenarios on the substantial change in ownership of the shares in a company and when would such a guideline be issued

Answer:

(i) Refer to the above note.

(ii) Refer to the above note.

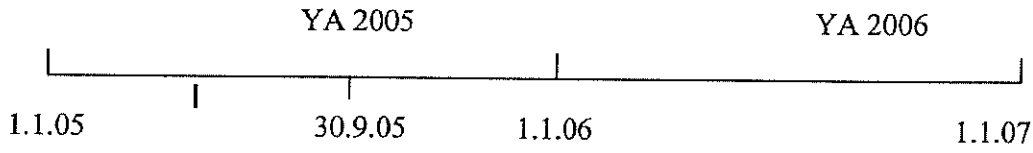
(iii) The amendment will not be applicable during the pioneer period.

(iv) Public Ruling will be issued on this topic as soon as possible.

1.5 Clause 10(2)(c) – Transitional provision of the Finance Bill 2005 provides that : -

"where the basis period of a company for the year of assessment 2005 ends on or

after 1 October 2005, the last day of the basis period for that company for the year of assessment 2005 shall be deemed to be 30 September 2005."



It appears that a change in shareholding from Shareholder X to Shareholder Y on say, 1.11.05 results in the losses for year of assessment (YA) 2005 (1.1.05 to 31.12.05) being ineligible to be carried forward to year of assessment 2006 as the shareholding on the last day of the basis period for YA 2005 (i.e. deemed 30.9.05) is not substantially the same as the shareholding on the first day of the basis period for YA 2006 (i.e. 1.1.06). The Institutes seek a confirmation of this.

Answer: **Refer to the above note.**

The above provision results in this new "rule" being applied to acquisitions of loss companies on a date after the end of the year of assessment 2005 (which is before 30 September 2005), but before the release of the Finance Bill 2005 on 30 September 2005.

For example,

- Co. B genuinely acquired Co. C, a loss company, from Co. A on 1 September 2005 when the share sale agreement was executed.
- Co. B and Co. A are not related.
- Co. C's basis period for YA 2005 ended on 30 June 2005 (financial year ended 30 June 2005).
- Co. C had unabsorbed losses and capital allowances in YA 2005.

Applying the provision, Co. C's losses will no longer be available for use from YA 2007 onwards.

Co. B is prejudiced as it acquired the company in good faith and without knowledge of the losses not being available for utilisation under the new provision. The new proposed provision thus has an element of retrospectivity which can certainly affect the integrity of the tax system.

In addition, the agreement to acquire a loss company could have been made on 1 September 2005 but the transfer of shares actually occurred later, say on 31 October 2005. It would thus appear that such a transaction would be affected by the new provision.

The Institutes wish to appeal to the Minister of Finance to:

(i) Consider redrafting the special provision relating to Section 44 to avoid acquisition of companies such as the above that took place before the release of the Finance Bill 2005.

(ii) Consider favourably an application under Section 44(5D) for acquisitions

such as the one mentioned above.

Answer:

Refer to the above note.

1.6 Consider the following scenario:

Dates	Shareholders of Co E
30.9.05	A: B (50%:50%)
1.1.06	A: B (1%:99%) - arising from allotment of additional shares to B

The Institutes wish to seek confirmation that the change outlined in the above example does not constitute a substantial change in the shareholding of Co E as the paid-up capital of Co. is held by the same persons on both dates.

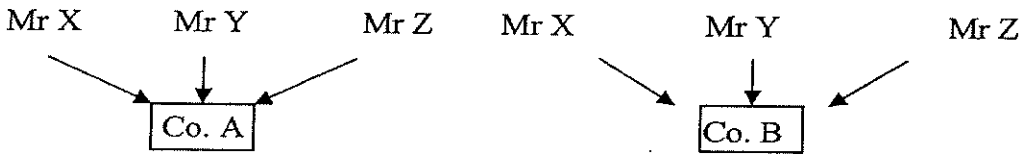
Answer:

The IRBM clarified that the test to determine the existence of a substantial change is whether 50% of the company's shareholding is held by the same shareholder on both dates. Therefore, the above scenario does not constitute a substantial change since both the shareholders are the same before and after the allotment of additional shares to B. There is only a change in the percentage of shareholdings but the common shareholders collectively still hold more than 50% of the shares in the company.

1.7

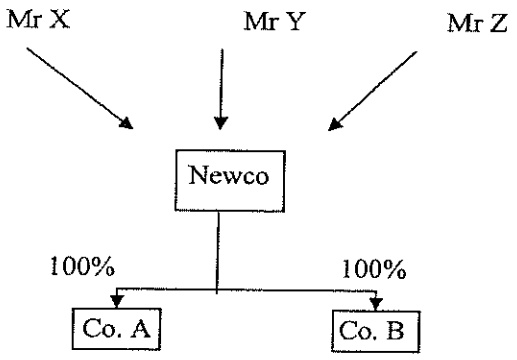
Before Restructuring

Co. A - Shares held by Mr X, Mr Y and Mr Z equally
Co. B - Shares held by Mr X, Mr Y and Mr Z equally



After Restructuring

NewCo is formed to acquire the shares of Co A and Co B. The consideration is by issuance of NewCo's shares to Mr X, Mr Y and Mr Z.



The Institutes wish to seek confirmation that the above restructuring exercise does not constitute a substantial change in the shareholding of Co. A and Co. B.

Answer:

Refer to the above note.

1.8 It has also been proposed under Section 44(5D) of the Act that the Minister may, under special circumstances, exempt that company from the continuity of ownership test. In cases of genuine acquisitions of ongoing businesses (with employees, assets, liabilities, etc) by a loss making company with the intention of turning around the business, it would be unfair that unabsorbed losses and capital allowances are disallowed following changes that are essential to the future well-being of the company.

The Institutes seek clarification of the following:-

(i) the definition of "special circumstances" and the procedures for applying and hope that guidelines will be issued as soon as possible in the interest of transparency and certainty.

(ii) how fast will the exemption be granted from the date of application? To avoid any delay in the group restructuring exercise and other practical difficulties as well as administrative burden in dealing with various applications for exemption, the Institutes propose that so long as the loss-making company remains within the group before and after the group restructuring exercise, then the carry forward of losses and capital allowances should not be affected.

Answer:

Refer to the above note.

2. Group Relief

2.1 Finance Bill – Clause 11 on new Section 44A(10)

"The provisions of this section shall not apply to a company for a basis period for a year of assessment where the period during which that company –

(a) is a pioneer company or has been granted approval for investment tax allowance under the Promotion of Investments Act 1986;
(b) is exempt from tax on its income under Section 54A, paragraph 127(3)(b) or subsection 127(3A);
(c) has made a claim for a reinvestment allowance under Schedule 7A;
(d) has made a claim....."

The Institutes seek clarification whether this applies to both the claimant and surrendering companies.

Answer:

Yes, the relevant provision has been amended and the provision is applicable to both the claimant and surrendering company.

2.2 An irrevocable election to surrender or claim an amount of adjusted loss must be made by the surrendering company and claimant company in the tax return.

The Institutes are of the opinion that penalties should not be imposed where the losses claimed are adjusted by the IRB to a lesser amount in the event of a tax audit or other circumstances.

Answer:

The IRBM clarified that whether the penalty will be imposed is based on the principle of whether there is an element of non-disclosure (element of tax avoidance). Generally, no penalty will be imposed on the claimant company. However, in circumstances where the claimant company has some knowledge (information) of the non-disclosure, then penalty may be imposed on that company.

2.3 For the purpose of determining the initial tax estimate for companies with a 31 December year-end (which is due on 1 December 2005), can a company claim 50% of the current year losses of the surrendering company?

Answer:

The IRBM clarified that the threshold for estimate of tax payable for companies from YA 2006 has been reduced from 100% to 85% of the estimate of tax payable for the immediately preceding year of assessment. The company is allowed to make a revision within 6 months of the basis period.

2.4 What is the mechanism to claim or surrender the loss? Is it to be claimed or surrendered in the Form C? What is the penalty mechanism involving a surrendering company which is making losses i.e. how will this be applied considering that such a company may be a loss-making company? The Institutes wish to highlight that the IRB should take cognizance that genuine errors can occur in the course of completing tax returns. As such, imposition of penalties should not be done without culpability being proven.

Answer:

The IRBM clarified that a claim or a surrender of loss shall be made in the Form C. There will be a column for claiming the Group Relief.

Regarding the imposition of penalty, if there is an adjustment on the claimant company, penalty will be imposed on the surrendering company and the amount of penalty is equal to the amount of tax undercharged on the claimant company. Therefore, in the case of a loss-making surrendering company, penalty can still be imposed on that surrendering company even though no tax has been charged on that surrendering company. The IRBM will work on the mechanism of that penalty imposition.

2.5 To create a more competitive tax environment and to encourage foreign direct investment in Malaysia, the Institutes have interpreted from the proposed legislation that so long as the surrendering and claimant companies are locally incorporated resident companies and are related to the extent of at least 70%, group relief is applicable regardless whether the ultimate holding company is a non resident company or whether it is incorporated overseas.
The Institutes seek to reiterate that the fact that the surrendering and claimant companies are directly and indirectly owned by another company
(which may be a non-resident foreign incorporated entity) should not jeopardize the eligibility to claim group relief under Section 44A of the Act as the section states that only the surrendering company and the claimant company needs to be resident and incorporated in Malaysia. Please confirm our understanding.

Answer:

The IRBM confirmed that the conditions of a company's incorporation and resident status are applicable to both the surrendering and the claimant company. The relationship between the surrendering and the claimant company can be direct or indirect.

2.6 The Institutes would also like to seek clarification on the tax treatment for any consideration to be paid by the claimant company to the surrendering company for the amounts of losses to be surrendered. This would be possible where there are minority shareholders in a company. The Institutes are of the view that such payment would not be taxable on the surrendering company and consequentially will not be allowable on the claimant company as the amount represents a capital payment. This treatment is consistent with that adopted by the United Kingdom's HM Revenue & Customs.

Answer:

The IRBM informed that the issue is noted and will be studied.

2.7 In view of the number of scenarios that may be involved in applying group relief due to different group structures, the Institutes would appreciate it if detailed guidelines can be issued to further clarify the application of the above proposal as well as the time frame within which the guideline will be issued.

Answer:

The IRBM will issue a detailed guideline as soon as possible.

3. Flexibility in Estimating Tax Payable for Companies

It has been proposed that the initial tax estimates provided by companies be lowered from not less than 100% to not less than 85% of the preceding year's estimates or revised estimates.

The Institutes note that the Treasury has recognised the difficulties faced by businesses, especially in estimating the initial tax estimates. However, the Institutes urge the removal of the 85% restriction in order to fully promote a self assessment regime or perhaps institute a gradual reduction of the limitation in the coming years.

Answer:

The IRBM responded that the above matter is a policy decision.

4. Tax Treatment of Small Value Assets

It is proposed that capital allowance on qualifying expenditure on small value assets be given 100% allowance provided each asset does not cost RM1,000 each. However, the total qualifying expenditure shall not exceed RM10,000.

The Institutes welcome this proposal. However, this is not in line with the original intention of the Institutes' proposal to converge the accounting and tax treatment for small value assets. In addition, the limitation of RM10,000 is considered immaterial to most organisations. In fact, the limitation will lead to higher compliance costs to monitor the movement of the small value assets and it does not reduce the administrative work in preparing tax computations.

Due to the additional work involved, the Institutes also wish to highlight the following:-

(i) We would urge the authorities to consider allowing a full deduction on such small value assets rather than merely granting accelerated capital

allowances.

(ii) Alternatively, if tax deduction without any limit is not acceptable, we propose that taxpayers be given an option to either claim capital allowance on small value assets acquired in YA 2006 and thereafter based on the existing provision (i.e. normal capital allowance) or based on the proposed legislation (i.e. 100% capital allowances).

Answer:

(i) The IRBM responded that the above matter is a policy decision.

(ii) The IRBM informed that taxpayers are given an option to claim capital allowance on small value assets acquired in YA 2006 and thereafter, based on the existing provision (i.e normal allowance) or the new legislation (i.e. 100% capital allowance).

Under the Self Assessment System, whatever is claimed in the Form C reflects the taxpayer's option.

5. Tax Treatment of Interest Expense for Leasing Activity

It is proposed that interest expense incurred by companies undertaking both leasing and non-leasing activities be apportioned based on the respective amount of funding used. The Institutes understand that the apportionment method may be based on Bank Negara's average cost of funds formula.

The Institutes would like to seek clarification on the following issues:-

(i) how does the formula for the average cost of funds work?

(ii) as all are aware, the apportionment issue for leasing companies has been debated for a long period. To ensure that fair treatment is accorded and with the amendment taking effect from YA 2006, the Institutes would suggest that the proposal be extended, as a concession, to cases arising prior to YA 2006.

Answer:

(i) The IRBM clarified that the Ministry of Finance has formulated the formula for the average cost of funds as follows:

$$\text{Average Interest Expense} = \frac{\text{Sum of (C) for the Months in the Year}}{\text{Number of Months in the Year}}$$

Where,

(C) = (a) x (b)

(a) = annualized = Interest Expense for the Month x 365 Days x 100%
Average Cost Of Funds — Total Funds for the Month — Number of Days in the Month

(b) = Lease Rental Receivables Outstanding

(ii) The IRBM confirmed that the new law is applicable from YA 2006.

6. Investment Holding Company (IHC)

The definition of an investment holding company has been proposed to mean a company whose activities consist mainly in the holding of investments and not less than 80% of its gross income (whether exempt or not) is derived therefrom. If it is shown that it has been established between the Director General and the company for tax purposes that the company is an IHC for the basis period for any year of assessment, it shall be presumed to remain an IHC until the contrary is proved.

The Institutes wish to:-

(i) seek confirmation as to whether the transitional treatment would continue to apply to those IHCs in which rental income has been recognised as

business income under *Paragraph 12 of the Public Ruling 1/2004*, "*Transitional treatment under the Director General Ruling No.1/95*" where, if a company has been treated as carrying on a business of letting properties under Director General Ruling No. 1/95 (old Ruling), this treatment shall continue until such time the company is no longer eligible to do so under the old Ruling such as the disposal of 1 or more units of property acquired in the basis period for year of assessment 2003 or earlier (old property);

(ii) seek confirmation on the procedure and manner for a company to establish with the IRB that it is an IHC (possibly in the form of a written confirmation) and also how the contrary would need to be proved under the self-assessment system.

(iii) propose the establishment of a specific division/unit in the IRB to provide similar confirmations as required under the provisions of the Act. Such division/unit will be able to centralize the issuance of confirmations and therefore avoid differences in opinion between different branches of the IRB.

Answer:

(i) The IRBM confirmed that Paragraph 12 of Public Ruling 1/2004 (PR) is not applicable to an investment holding company (IHC). It is clearly stated in that PR that the special treatment where rent can be regarded as a business source does not apply to an IHC.

(ii) Guidelines on the matter will be issued as soon as possible.

(iii) The IRBM took note of the above recommendation.

7. Investment Holding Company listed on Bursa Malaysia

The proposed section 60FA(2) provides that :-

"Where an investment holding company is a company resident for the basis year for a year of assessment and listed on the Bursa Malaysia in the basis period for that year of assessment, income of that investment holding company from the holding of investments in that basis period shall be treated as gross income of that investment holding company from a source or sources consisting of a business for that year of assessment."

The Institutes wish to seek clarification on the following:-

(i) whether the dividend, interest and rental income constitute separate sources of business income such that an adjusted loss in respect of dividends is not deductible against adjusted income in respect of interest or rental income? Alternatively, does the dividend, interest and rental income constitute a single source of business income?;

(ii) whether the residual expenditure (qualifying expenditure less notional allowance) of the qualifying assets acquired and used prior to YA 2006

would be eligible to be claimed as capital allowances in YA 2006 for a listed IHC; and

(iii) how would the common expenses such as director's fees of a listed IHC be allocated if a listed IHC has two or more sources of income? Will the basis of allocation be based on the gross income of investment and other income?

Answer:

(i) The IRBM clarified that dividend, interest and rental will constitute separate sources of income and the adjusted loss in respect of each source is not deductible against other sources of income.

(ii) The IRBM confirmed that the provision of paragraph 2A Schedule 3 ITA, applies.

(iii) The IRBM also clarified that the common expenses such as director's fees of a listed IHC will be allocated based on the gross income of each source of income.

8. Extending the Scope of Allowable Expenses for Companies

The 2006 Budget proposed that expenses incurred on audit fees by companies are to be deemed as allowable expenses for deduction in the computation of income tax.

The Institutes note that audit fees is now eligible for deduction under the proposed legislation as in the past it was only allowed under a concession given by the IRB and this concession also applied to tax fees and secretarial fees as well. The Institutes welcome the initiative to be transparent in terms of providing certainty in respect of the deductibility of such an expense. Expenses such as tax fees and secretarial fees nonetheless are necessarily incurred by companies in the course of doing business. In this respect, the Institutes would like the following to be considered:-

(i) the same treatment should be accorded to secretarial fees and tax fees. Alternatively, a confirmation is required that the concession for the deduction of such fees would continue to apply.

(ii) the term "audit fees" should apply to statutory audit fees as well as other audit fees such as special audit fees, internal audit fees, etc which are required by other legislative provisions besides the Companies Act 1965.

Answer:

(i) The IRBM confirmed that the concession for the deduction of secretarial and tax fees would not be continued. Deductions given prior to YA 2006 will not be clawed back. For YA 2006, cases where a company has claimed those fees, the company must inform the relevant IRBM branch to effect an adjustment accordingly.

(ii) The IRBM also confirmed that "audit fees" will only apply to statutory audit fees.

9. Estimated Losses of Low Cost Housing Projects

It is proposed that in preparing the estimated tax payable for a current year, the estimated losses of low cost housing projects shall be allowed to be set off against the estimated profits of other property development projects, with effect from YA 2006.

The Institutes wish to confirm that the estimated losses of low cost housing projects are also deductible when filing the tax returns for a year of assessment. If not, this may result in a penalty for under-estimation of tax payable when filing the returns. The Institutes wish to enquire as to when the ruling will be issued.

Answer:

This matter is addressed in the public Ruling on Property Development and Construction Contracts which has been issued.

10. Mergers and Acquisitions of Listed Companies

It is proposed that stamp duty and RPGT exemption be given on mergers and acquisitions (M & A) undertaken by companies listed on Bursa Malaysia.

The Institutes would like to enquire as to the scope of the M&A envisaged and whether both companies being merged require to be listed, or is it sufficient that any one of the companies be listed in order to qualify for the exemption. The Institutes are of the opinion that the M & A exercise should not be restricted to acquisition of the businesses of public listed companies. Partial acquisition which enables a listed company to grow larger by acquiring a business segment/division from another listed company should also be considered for this incentive so long as the exercise results in improving efficiency and expansion of business activity.

The Institutes also wish to request that the IRB invites the Institutes to provide input on the above guidelines which will be drafted by the Securities Commission.

Answer:

The IRBM informed that this incentive is applicable only to Public Listed Companies (PLC). IRBM has not been contacted for any input on the preparation of the guidelines.

11. Extending the Scope of Allowable Expenses for REITs

It is proposed that consultancy, legal and valuation fees incurred in the establishment of REIT be allowed a tax deduction effective from YA 2006.

The Institutes wishes to seek confirmation on the following:-

(i) What type of expenses would be included? To further encourage the growth of the property sector, the deductibility of other expenses such as underwriting fees, cost of printing prospectus, etc should be allowed.

(ii) Are the expenses to be deducted at the REIT level or by the asset owner who initiates the setting up of the REIT?

Answer:

(i) The IRBM confirmed that only expenses of consultancy, legal and valuation fees incurred in the establishment of REIT would be allowed a tax deduction. IRBM responded that it is a policy decision to allow these expenses only.

(ii) The IRBM confirmed that the expenses are to be deducted at the REIT level.

12. Review of tax treatment of bonds

12.1 It is proposed that the tax treatment for non-financial institutions (NFIs) be streamlined to follow that of financial institutions by taxing accretion of discounts or allowing amortisation of premiums on such instruments using the accrual principle.

(i) While the Institutes welcome the streamlining of the tax treatment, there is a concern for investors who will be taxed every year on accrued income which will only be received upon maturity.

(ii) The Institutes also wish to confirm the tax treatment for NFIs which have already issued bonds or have current bond investments that straddle into the basis period for YA 2006 as outlined in the following example:

XYZ Sdn Bhd issued bonds with a nominal value of RM100 million at a discount of RM15 million in the year 2004. The bonds, with a tenure of 5 years, will mature in 2009. For accounting purposes, the discount of RM15 million is amortised over 5 years with a charge of RM3 million to the Profit and Loss account each year. For tax purposes, the amortisation of discount of RM3 million each has been disallowed as a tax deduction for YA 2004 and YA 2005. The full discount of RM15 million will be claimed as a tax deduction in YA 2009 when the bonds mature.

In view of the proposal to streamline the tax treatment for FIs and NFIs, will the amortisation of discount of RM3 million each for YA 2004 and YA 2005 be given a deduction in YA 2006 together with the RM3 million relating to YA 2006, or will the amortisation of discount of RM3 million each be given a deduction in YA 2004 and YA 2005 necessitating their prior years' returns to be re-submitted?

Answer:

(i) The IRBM confirmed that the amortization of discount is on a straight line basis. Prior to YA 2006, no deduction is to be allowed. Any amortized discount made prior to YA 2006 will be allowed in the year of maturity.

(ii) The prior years' assessments will not be re-opened and therefore the balance that has accrued but not yet claimed will be allowed in a final year.

12.2 A detailed guideline or public ruling should be issued to clarify various matters including:

(i) tax treatment for bond issuers and investors which may consist of resident and non-resident individuals or corporate bond holders;

(i) would the non-resident bond holder be subject to withholding tax and when and how should this be accounted for?

(iii) how should a "Zero Coupon Bond" be treated for income tax purposes? Would the discount be treated as interest? How should the individual bond holder account for the discount income earned annually for the purpose of assessing his/her tax payable?;

In view of the above issues, the Institutes propose that the bond issuer be allowed to assess/deduct the discounts/premium on an annual basis until the date of maturity of the bonds while the investor (either the resident or non-resident individual/corporate bond holder) be liable to pay tax for the total discount income earned throughout the term of the bond only upon maturity/realisation.

Answer:

The guidelines will be issued to clarify the matter.

13. Employee Share Option Scheme

13.1 The term "market value" has been defined to mean –

(i) in the case of a company listed on Bursa Malaysia, the average price of the shares which is ascertained by averaging the highest and the lowest price of the shares for the day; or

(ii) in any other case, the net asset value of the shares for the day.

The Institutes wish to seek confirmation on the following:-

(i) in instances where the employees are granted stock options of companies not listed on Bursa Malaysia but which are listed on foreign exchanges such as the New York Stock Exchange or Singapore Stock Exchange, the same definition of market value for companies listed on Bursa Malaysia should apply as it would be more practical and administratively easier;

(ii) whether the proposed tax treatment also applies to other types of share schemes offered by the employer for the benefit of the employee;

(iii) the definition of "net asset value" and the method of determining the net asset value of shares for the day for shares not listed in Bursa Malaysia

We wish to highlight the potential administrative issues involved in tracking the number of shares exercised by the numerous employees, daily share prices of the company, etc.

Answer:

The issues will be covered in the amended Public Ruling.

13.2 Whether the above proposal would be applicable to share options granted prior to year of assessment 2006 but which are only exercised by employees in

subsequent years (The Institutes propose that in the interest of justice and equity, the above proposal should not be applicable to such share options to avoid any retrospective application of the proposal. Accordingly, a transitional provision to this effect should be included in the amendment act whereby such share options should be subject to the tax treatments as stated in the Public Ruling 4/2004).

Answer:

The Minister has agreed that the proposal will not be applied to share option schemes exercisable prior to 1st January 2006 on condition that the option must be exercised by 31 December 2006.

13.3 What tax treatment should be adopted for the existing share plans which have been submitted to the IRB whereby the IRB has issued their written confirmation on the timing of taxability and taxable value? Will there be transitional guidelines issued at a later date?

The Institutes would like to know when the Public Ruling 4/2004 on Employee Share Option Scheme would be revised to take into account the new proposal.

Answer:

The IRBM informed that the new legislation will be applied. Since the new legislation has been introduced, the computation and taxable benefit will be applied according to the new law. Old computation of taxability and taxable value will only be applied during the transitional period. No transitional guidelines will be issued.

13.4 Prior to the 2006 Budget Proposal, a taxable benefit would be reported in the year of exercise and related back to the year of grant as prior year income for taxation purposes. However, the proposed amendments require that the taxable benefit arising from share options would be reported as current year income in the year of exercise.

The Institutes wish to seek clarification whether a taxable benefit arises in a scenario where an individual is granted share options prior to his assignment in Malaysia but exercises his share options during his assignment in Malaysia.

Answer:

The IRBM confirmed that a taxable benefit will be considered to arise in Malaysia where the share options are granted in respect of an employment exercised in Malaysia.

14. Extending the scope of incentives for multimedia activities

It is proposed that selected companies, which are undertaking ICT and multimedia activities including Regional Shared Service Centres outside the

Cybercities be given the following incentives, provided they are recommended by the Multimedia Development Corporation (MDC):

(i) Pioneer Status with tax exemption of 50% of statutory income for a period of 5 years; or

(ii) Investment Tax Allowance of 50% of qualifying capital expenditure incurred within a period of 5 years to be set-off against 50% of statutory income for each year of assessment.

In this regard, the Institutes would like to enquire from the IRB as to the criteria that will be used by the MDC to recommend such companies for the above incentives.

Answer:

The IRBM responded that the Malaysian Development Corporation (MDC) will determine the criteria for such incentives.

15. Incentive for unemployed graduates training scheme

It has been proposed that allowances given by listed companies to participants in the Unemployed Graduates Training programmes during the period from 1 October 2005 to 31 December 2008 be given a double deduction. These programmes need to be endorsed by the Securities Commission.

The Institutes would like to suggest that the scope be widened to allow non-listed companies, including the professional firms which also participate in such schemes to obtain the double deduction.

Answer:

The IRBM clarified that the incentive is only applicable to public listed companies.

16. Scope of Individual Tax Relief for Further Education

It has been proposed that the scope of courses eligible for relief not exceeding

RM5,000 per annum be extended to include any course of study up to tertiary level in any institution or professional body in Malaysia recognised by the Government or approved by the Minister, as the case may be, undertaken for the purpose of acquiring law and accounting qualifications.

The Institutes urge that the relevant authorities issue the list of institutions and professional bodies in Malaysia recognised by the Government or approved by the Minister as soon as possible. The Institutes also wish to highlight that education undertaken to obtain professional tax qualifications should be viewed as falling within the ambit of "accounting". This will encourage more persons to take up professional qualifications related to taxation especially since there is a

need for more tax professionals to provide the relevant services to taxpayers under the self-assessment system of taxation.
In addition, the Institutes would like to seek confirmation on the following matters:

(i) whether all the fees charged by the approved institutions such as registration fees, student fees, administrative fees, examinations fees, revision fees and tuition fees which are incurred/expended up to the maximum of RM5,000 will qualify for the relief; and

(ii) whether the cost incurred in acquiring professional accounting qualifications by way of self-study (as is done for most professional qualifications) would be eligible for the relief.

Answer:

(i) The IRBM confirmed that all fees paid for the purpose of attending the course of study excluding fees in respect of accommodation and sustenance are allowable.

(ii) The IRBM clarified that the cost incurred in acquiring professional accounting qualifications by way of self-study would be eligible for the relief. A list of professional bodies, approved in respect of this relief will be issued by Ministry of Finance.

17. Provision to Allow a Tax Assessment after Six Years

It has been proposed that the Director General of Inland Revenue be empowered to make assessments for income tax, petroleum income tax and real property gains tax after a period of 6 years in cases where the assessment is determined by the court or upon the withdrawal, revocation or cancellation of any exemption, relief, remission or allowance.

The Institutes would like to know the rationale and scope of the above proposal, whether it relates to a specific matter or party concerned and how this proposal is intended to be applied in future. The Institutes would also suggest that the IRB reviews and confirms all claims for relief and allowance within six years from the relevant year of assessment so as not to burden taxpayers with the need to maintain their records beyond these years in the event of a dispute.

In addition, the Institutes would like to clarify whether the number of open years is not limited to 6 years and taxpayers would need to keep their records for more than 7 years to prove compliance with the legislation. In the interest of efficiency and to maintain a business friendly environment, the Institutes are of the view that 6 years is too long a period for the IRB to raise an assessment and recover the tax after the withdrawal, revocation or cancellation of any exemption, relief, remission or allowances. It is believed that the IRB can, under self-assessment, raise such assessments much earlier than 6 years.

Answer:

The IRBM clarified that the proposal will allow the IRBM to make the necessary assessments under specific circumstances and hence it would not be subject to any restriction.

The term "exemption" is intended to mainly refer to those exemptions granted by MIDA with conditions attached.

The IRBM also clarified that under normal circumstances the keeping of records is subject to section 82. In the case of raising the assessment and recovering the tax after the withdrawal, revocation or cancellation of any exemption, relief, remission or allowances, normally IRB will take immediate action.

18. Waiver of the need to gazette tax exemption

It has been proposed that exemption of income tax, real property gains tax and stamp duty given only on a case-to-case basis be effected without the requirement for gazette notification.

Although the Institutes appreciate the rationale of deeming that the relevant letter of exemption would be adequate for such cases due to the long delays that occur

between the approval and the actual gazetting of the exemption, there is also a need to balance this administrative rationale with the need for transparency and accountability as the government gazette is for public consumption and all parties have the prerogative to be kept aware of who has been granted an exemption.

The Institutes would suggest that the proposal be withdrawn. Instead, the relevant tax authorities can be directed to accept the official letter of exemption issued by the Ministry of Finance to have the force of law instead of insisting on the actual gazette order.

Answer:

The IRBM responded that the above is a policy decision.

19. Enhancing the competency of tax agents

It has been proposed in the 2006 Budget that a person who wishes to perform tasks relating to taxation be required to obtain a tax agent license. However, a licensed auditor who has been granted an audit license prior to 1 January 2006 shall be allowed to continue to be a tax agent.

The Institutes welcome the move by the IRB. It is hoped that the Institutes would be involved in the transitional process. The Tax Committees of the Institutes should be allowed to send a representative to sit in the interview panel which

would be responsible in determining the suitability of the applicants. In addition, we would also like to seek confirmation on our interpretation of the proposed special provision relating to Section 153 of the Act i.e. that the existing auditor who obtains his/her audit license prior to 1 January 2006 is NOT required to apply for a tax agent license even upon renewal of his/her audit license in future.

Answer:

The interview by the IRBM is for the purpose of recommending candidates to MOF in connection with paragraph 153(1)(c).

The IRBM confirmed that the existing auditor who obtained his/her audit license prior to 1 January 2006 is required to apply for a tax agent license upon expiry of his/her audit license.

20. Gazette Orders

The Institutes would like to request the authorities to stipulate a time frame for the issuance of the relevant gazette orders for the following 2006 budget proposals:

- Exemption of withholding tax on non-resident personnel providing training in the performing arts and the production of crafts
- Tax treatment on estimated losses of low cost housing projects
- Tax deductions on certain start-up expenses incurred on the establishment of Real Estate Investment Trusts (REITs)
- Industrial building allowance on buildings located at Cyberjaya occupied by MSC Companies
- Tax deduction on expenses incurred for new courses by private higher education institutions
- Tax deduction for audit fees
- Tax treatment to allow companies to carry forward unabsorbed tax losses and capital allowances incurred during the pioneer period to the post pioneer period
- Extension of application period for incentives for promoted areas
- Extending the scope of incentives for multimedia activities
- Extending the scope of incentives for private higher education institutions
- Incentive for unemployed graduates training scheme
- Incentive for industrialized building system
- Incentive for generation of renewable energy
- Incentive for conservation of energy
- Remission of stamp duty on loan instruments for small and medium enterprises

Answer:

The status of the relevant gazette Orders which are under the jurisdictions of the IRBM is as follows:-

Gazette Orders	Status
Exemption of withholding tax on non-resident personnel providing training in the performing arts and the production of crafts.	The relevant Order will be issued soon.
Tax treatment on estimated losses of low cost housing projects (Public Ruling).	The Public Ruling has been issued on 13.03.2006
Tax deductions on certain start-up expenses incurred on the establishment of Real Estate Investment Trusts (REITs).	The relevant Income Tax Rules has been gazetted on 30.03.2006. Income Tax (Deduction For Establishment Expenditure Of Real Estate Investment Trusts Or Property Trust Fund) Rules 2006.
Industrial building allowance on buildings located at Cyberjaya occupied by MSC Companies.	The relevant Rules will be issued soon.
Tax deduction on expenses incurred for new courses by private higher education institutions.	The relevant Rules will be issued soon.
Tax deduction for audit fees.	The relevant Income Tax Rules has been gazetted on 30.03.2006. Income Tax (Deduction For Audit Expenditure) Rules 2006.
Incentive for unemployed graduates training scheme.	The relevant Rules will be issued soon.
Incentive for industrialized building system.	The relevant Rules will be issued soon.
Remission of stamp duty on loan instruments for small and medium enterprises.	The relevant Income Tax Order has been gazetted on 13.04.2006. Stamp Duty (Remission) (No.2) Order 2006.

B. ISSUES RELATING TO PREVIOUS BUDGET PROPOSALS

With reference to pages 53 to 57 of the 2006 Budget Commentary & Tax Information prepared by the Institutes (see Appendix A), the Institutes would like to enquire on the status of the issuance of statutory orders or amendment to the existing legislation (where applicable) for the previous budget proposals.

Answer:

As per Appendix B attached.

C. OTHER MATTERS

1. Basis period for first year of assessment

As stated in Paragraph 3.5.2 of *Public Ruling No. 7/2001: Basis Period for Business & Non-Business Sources (Companies)*, where a company commences operations and its first accounts are made up for 12 months, that accounting period is the basis period for the year of assessment in which the accounts are closed. In practice, members of the Institutes have encountered situations whereby the basis period of a newly incorporated company falls short by 9 days but such companies are required to comply with the requirement under paragraph 3.5.3 which is for accounts prepared for less than or more than 12 months and not ending on 31 December. The application of paragraph 3.5.3 would result in the overlapping of two basis periods and more time and work is required to deal with the situation in spite of the fact that the adjusted income of the second basis period will be disregarded.

In view of the practical difficulties faced by taxpayers and to achieve efficiency and effectiveness in the tax administration, the professional bodies would like to seek a concession from the IRB whereby the basis period of a company which is not less than 350 days be deemed as a completed year in determining the basis period of a company.

Answer:

The IRBM responded that approval or concession will be given on a case to case basis. The approval has to be obtained from IRBM, Technical Department.

2. Previous dialogues

The Institutes would also like to know the status of the issuance of public rulings or guidelines which the IRB had indicated would be issued in the previous dialogues such as the Guideline on Tax Treatment for Asset-Backed Securities which are understood to have been forwarded to the Legal Department for review as well as the Public Ruling on Section 75A of the Income Tax Act, 1967.

Answer.

The IRBM took note of the outstanding guideline.

D ADDITIONAL ISSUES

1. Carry forward of losses and unabsorbed capital allowances

1.1. What is the effective date of change in shareholding for the purpose of applying the continuity of shareholding test under Section 44(5)?

a. Date of signing of S&P
b. Date of completion of S&P agreement, or
c. Date of legal transfer

Answer:

The IRBM agreed that the effective date of substantial change in shareholding is the date of legal transfer i.e actual transfer of shares where the transferred share is registered under the name of the new shareholder by the Registrar.

1.2. Definition of "ordinary shares" in Section 44(5C). What does the word "only" qualify or is the word redundant?

Section 44(5C)
In subsection (5B), ""ordinary share" means any share other than a share which carries only a right to any dividend which is of ....

The words" ..., share *which carries only a right to any dividend* ..." could mean that the shareholder only has the right to dividends and not any other rights. Does the definition only exclude share which carries only one right?. However, shares have a whole host of rights attached. Clarification is required from the IRB as to what shares are intended to be excluded from the definition.

Answer:

The above definition of ordinary shares is intended to exclude preference shares.

2. Group relief

Commercial loan is defined in Section 44A(12) as:-
"Any borrowing which entitles the creditor to any return which is of only -

i. A fixed amount or at a fixed rate per cent of the amount of the borrowing; or
ii. Of a fixed rate per cent of the profits of the company."

The Institutes would like to seek confirmation whether the following loans would qualify as commercial loans:-

a. Loan at floating rate e.g. overdraft with floating BLR
b. Loan at "fixed rate + BLR"

Answer:

The IRBM confirmed that the above will qualify as commercial loans.

3. Investment Holding Company (IHC)

The Institutes would like to seek further clarification on the following matters:

- Whether the definition would be applicable to special purpose financing vehicles incorporated solely for a particular exercise such as assets backed securities.
- Should the definition be extended to these special purpose financing vehicles, would the PU order (such as Income Tax [Deduction for Expenditure on Issuance of Asset Backed Debt Securities] Rules 2003) be amended as the said PU order currently grants deductions on certain expenses in ascertaining the adjusted business income of the special purpose vehicle.

Answer:

The IRBM responded that the issue will be clarified in the guidelines.

4. Investment Holding Company listed on Bursa Malaysia

The new section 60FA(3) provides that any unabsorbed capital allowance will not be allowed to be carried forward to subsequent years of assessment. Upon disposal of the asset in a subsequent YA, there would be practical problems in calculating the capital allowance (CA) apportioned to and claimed by the respective deemed business income sources in order to determine the correct balancing adjustments (balancing charge) to be made. Part of the apportioned capital allowance may not have been fully absorbed by the respective deemed business income and tracking the actual CA absorbed for a particular asset would be very cumbersome.

Answer:

The IRBM responded that the issue will be clarified in the guidelines.

5. Review of tax treatment of bonds

In the 2006 Budget, it was proposed that equal tax treatment be accorded to non-financial institution and financial institution on the issuance of bonds i.e. to adopt accrual principle for tax treatment on discount and premium.

It is presently unclear how this will apply to non-financial institution i.e. Investment holding company, special purpose vehicles etc. The institutes are of the view that further amendment to the law or Ruling should be issued to clearly implement the proposal.

Answer:

The IRBM responded that the issue will be clarified in the guidelines.

CONCLUSION

Last but not least, the Institutes would like to thank the authorities for considering some of the issues proposed in our Budget Memorandum. It is noted that the Government has agreed to some of the convergence issues. The Institutes hope that proper guidelines will be made available to the public in due course to address the ambiguous issues. Apart from that, we also hope that sufficient time is given to the taxpayers to understand and adapt to the new proposed legislation. The authorities should be lenient in the implementation and enforcement of the new provisions as the process of educating taxpayers is a crucial element in the tax system.