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INTRODUCTION

As we cross the 50 year mark as an independent nation, it is important that the country leverage on the strength of our diversity and remain focused in our quest towards achieving developed nation status.

The nation has achieved significant progress with a substantial improvement in the quality of life since independence. Economic growth for 2007 remains strong at 6.3% while the economic fundamentals continue to strengthen with the strong foreign direct investment (FDI) inflows as well as the provision of world-class infrastructure facilities to support industrial development.

The diversified economic structure, more developed financial markets and sound financial sector together with private and public sector spending should continue to provide support for economic growth as well as resilience to withstand external shocks.

The need to further enhance the services sector is indeed crucial and human capital is an important element in this exercise. No doubt a lot is being spent on education but there is a need to plan carefully and to look at both the demand and supply sides of the knowledge economy as well as the fact that a sizeable number of our professionals are working overseas. The retention of such skills may be difficult. Nevertheless, there is a need to look into ways of ensuring that the country's need for such skills is met.

The Malaysian Institute of Taxation (MIT) is pleased to submit a memorandum relating to fiscal proposals for consideration in the forthcoming 2009 National Budget. The proposals have been broadly categorised under the following categories:-

- Improving the efficiency of tax administration
- Maintaining a competitive fiscal environment
- Continuous review in ensuring an equitable and business-friendly taxation system
- Stimulating the business environment
- Development of Human Capital
- Promoting a caring society

We hope that the matters suggested in the memorandum will contribute towards the preparation for the 2009 National Budget.

A. IMPROVING THE EFFICIENCY OF TAX ADMINISTRATION

1. Public Rulings/Guidelines/Legislative Amendments

Since the self assessment system started, the Inland Revenue Board(IRB) has issued guidelines/public rulings to provide guidance to the public and officers of the IRB in respect of tax laws, policies and procedures to be complied with. The Institutes are of the view that public rulings issued should not be applied retrospectively.

Taxpayers (including individuals) are required to make a disclosure in the income tax return form as to whether they have complied with the relevant Public Rulings. It is noted that some of the Rulings would not be relevant to an individual. This requirement to disclose vests the Rulings with some degree of "power" to compel compliance on the part of taxpayers although it is only intended as a guide. Rulings are issued to provide guidance for the public and officers of the IRB and in essence, set out the interpretation of the Director General of the IRB (DGIR). This presents an unfair dilemma to taxpayers. Taxpayers should not be penalised if they have a different interpretation of the law as long as it is supported by a valid basis.

Various public rulings/guidelines need to be updated due to changes in the law. For example, the 2008 Budget was presented in September 2007, the Finance Act 2007 was gazetted in December 2007, and yet the relevant public rulings/guidelines are still not updated.

Taxation must keep pace with business developments. The taxation of electronic commerce activities is one area that requires guidelines so that there is clarity about the tax treatment of such activities. Specific provisions/guidelines are also needed to specify the tax treatment of financial instruments.

Proposal

The following measures are proposed:-

(a) The effective date for laws or any guidelines/public rulings should commence from the date such announcements, legislation or amendments to the legislation are made and announced to the public and it should be prospective instead of retrospective. This is because retrospective treatment will cause hardship and it is unfair to taxpayers when a penalty is imposed during a tax audit on those tax returns which were submitted before the relevant public rulings were issued and the law was not clear at that point of time.

(b) Appropriate lead-time should be given to taxpayers to comprehend and understand the legislation or amendments made thereto. For example, the Public Ruling 1/2006: Perquisites from Employment which was issued by the IRB on 17 January 2006 should be effective from year of assessment 2006 instead of year of assessment 2005. It was unfair to taxpayers in view of the short notice given as the public ruling was only made available on the IRB's website in the middle of February 2006 while the individual taxpayers (without business income) are required to file their tax returns by 30 April 2006.

(c) Any guidelines/public rulings, etc should be announced and not just uploaded on the IRB website. The professional bodies should be alerted on any new developments. Alternatively, the IRB website must have an "Updates" or " Latest Developments" link on the website so that taxpayers can easily know what are the latest announcements rather than spending time looking all over the website. The same applies to the

Customs Department website.

(d) The requirement to disclose compliance with public rulings by a taxpayer in the tax return form should be removed. Taxpayers should not be asked to indicate compliance with the rulings which represents the DGIR's interpretation of the law.

(e) Specific guidelines/rulings should be issued on a timely basis to provide clarity on the tax treatment of new emerging business developments.

(f) The outsourcing of some of the technical research work of the IRB may be a possible approach to solving the human resource shortfall that the IRB may have. The forming of an Advisory Panel made up of prominent and respected practitioners may also be an approach to be considered so that timely changes can be implemented.

2. Assessment of Employment Income

2.1 Bonuses

Bonuses are generally paid to employees in respect of the services rendered in the preceding year. As such, a bonus received in 2008 for services rendered in 2007 would be declared in the tax return (Form BE) for year of assessment (YA) 2008 as prior year income. Hence, the IRB will have to raise an additional assessment (Form JA) for YA 2007 in respect of the bonus after the Form BE for YA 2008 is submitted by 30 April 2009.

Proposal

To promote a more efficient tax administrative system and to eliminate the administrative hassles, the Institute proposes that bonuses be taxed on the receipt basis and be declared in the Form EA for the year in which it was received. This avoids the need to issue an additional notice of assessment, etc.

2.2 Benefits and Perquisities

There are various categories of benefits (including allowances) and perquisites which are provided by employers, and although considered to be essential in carrying out the employment duties, these have to be reported no matter how small the quantum is. These benefits are also subject to Schedular Tax Deductions. This creates a tremendous administrative burden on the employers/employees in terms of monitoring such benefits as well as for employees having to then make claims for deductions against certain allowances, etc..

Proposal

The Institute proposes that the IRB have discussions/consultations with the relevant parties including professional bodies to determine a list of common benefits wherein the amount/value can be considered to be fully utilised in the carrying out of the employees' duties. This will relieve the employees/employers from monitoring such benefits and perquisites as well as making the filing of tax returns much simpler.

2.3 Consolidation of Personal Reliefs

At present, there are various reliefs that an individual may claim. In some cases, reliefs are only a small amount and the cost incurred to monitor, report, assess etc. is not beneficial. In determining eligibility for such reliefs, confusion may arise leading to errors and overclaiming of such reliefs. It also complicates the filing of tax returns.

Proposal

The Institute proposes that personal reliefs be consolidated into a few broad categories (for example, single individual and married individual) and the global personal relief amount will then be automatically (in some cases there could be a minimum and maximum amount stipulated subject to conditions) granted to the taxpayer. This will simplify the completion of tax returns and reduce errors as well as the tendency to claim all reliefs even if one is not entitled to do so.

3. Consolidation of Incentives Legislation

Currently various types of tax incentives are provided under the Promotion of Investments Act 1986, Income Tax Act 1967, various gazette orders, etc. Additions and amendments to the law over the years have made the legislation more complex. Furthermore these legislations are under the purview of different authorities e.g. MIDA, MDeC, IRB, MOF, etc.

Proposal

It is proposed that a relevant authority be appointed to consolidate the various incentives under one legislation for ease of reference and application by taxpayers and tax practitioners. This Act can categorise the various incentives under different themes which include :

(a) Reinvestment allowance;
(b) Industry specific incentives;
(c) Incentives for the services sector;
(d) Incentives for financial services sector; and
(e) Locational incentives (such as for the Economic Development Corridors)

4. Self Assessment System

Malaysia has now fully implemented the self assessment regime, which relies on taxpayers determining their income tax liability. The Government needs to continue to review the current regulations and administration of the tax system so as to improve tax compliance. Compliance management is not simply about audit, verification and enforcement. It is also about making it as easy as possible for taxpayers to comply.

The IRB should review the taxpayers' charter towards adopting a more open and fair approach in the treatment of taxpayers within the framework set by the law. The tax administration system should be further revamped to eliminate inefficiencies, bureaucratic bottlenecks and lack of clarity in rules and practices. There is need for the IRB to issue clear guidelines and clarifications on a timely basis to ensure transparency in the tax system and to assist taxpayers in making their financial decisions. The delivery system can be further improved with the aid of technology so that things can be done efficiently, at a lower cost and in a shorter time period with the minimum of hassle. More efficient processing of applications will promote confidence in the system. A business-friendly rather than bureaucratic tax system will not only enhance tax compliance but also add to Malaysia's competitive edge in attracting foreign investment.

In this regard, the Institutes would like to commend the Government and the IRB for its initiative in reviewing the current tax system, with a view to improving its efficiency, transparency and effectiveness. The process has to be maintained with the input and support of relevant agencies and professional bodies.

In this respect, the Institute would like to submit the following proposals for the Government's consideration.

4.1 Basis periods

The determination of basis periods varies for different categories of entities as well as depends on the financial year ends. To simplify the determination of the basis periods, the basis of determination for the various entities should be reviewed. Our proposals are as follows:-

(a) Sole-Proprietors and Partnerships

Under the current tax system, sole proprietors and partnerships are required to report their income for tax purposes based on the calendar year rather than the financial year adopted for the business.

Proposal

The Institutes are of the view that taxpayers should be using the financial year ends of their businesses for income tax purposes. Thus an individual who has a sole proprietorship business with a 30 September year end should be reporting the statutory business income for the year ended 30 September 2007 in the Form B to be filed by the end of June 2008 rather than having to report the business income for the year ended 31 December 2007.

(b) Company, Trust Body or Co-operative Society (Section 21A)

Section 21A provides that where a company, trust body or co-operative has made up the accounts of its operations for a period of 12 months ending on a day other than 31 December in the basis year, that period shall constitute the basis period for that year of assessment.

Proposal

It is proposed that even if a company, etc has made up its accounts for a period of less than 2 months ending other than 31 December, that period shall constitute the basis period for that year of assessment.

(c) Non-Corporate Bodies

Pursuant to Section 56 of the Trade Unions Act, 1959, the secretary of the trade union shall submit the audited financial statement of a registered trade union in respect of the period of twelve months ending on 31st March in each year before 1st October in every year. However, as stated in Section 21 of the Act, the basis year for a year of assessment in relation to a source of a person other than a company, trust body or co-operative society shall constitute the basis period for that year of assessment with effect from year of assessment 2004 i.e. the calendar year shall form the basis period.

In view of the different requirement of the Acts as stated above, practical problems arise in complying with the requirements of filing the tax return form. As required by the Trade Unions Act, 1959, the audited accounts for a trade union have to be closed on 31 March, but the Return Form T for a year of assessment is for the calendar year from 1 January to 31 December. In most of the cases, the audited accounts for say, 31 March 2007 would only be available in August or September 2007. In practice, it is difficult to estimate and apportion the income for the period from 1 April 2007 to 31 December 2007. This would create additional compliance issues.

Proposal

It is proposed that a trade union and any other non-corporate body be allowed to prepare their tax computations based on their financial year being taken to be the basis period for a year of assessment rather than on a calendar year basis. This will assist these taxpayers to comply fully with the filing requirements under the self assessment system.

4.2 Submission of revised income tax returns

Under the self-assessment system, there is no specific provision in the Income Tax Act to allow for the submission of a revised or amended tax return. The Institute suggests the introduction of a specific time period, for example a 6 month period, within which taxpayers are allowed to submit a revised tax return (which could include the correction of errors) without the imposition of penalty. It is inevitable that human errors do occur especially when there is a time constraint.

4.3 Revision of tax estimates

Under the self assessment system, every company is required to submit an estimate of tax payable of not less than 85% of the revised tax estimate for the immediately preceding year of assessment or if no revised tax estimate is furnished, not less than 85% of the tax estimate for the immediately preceding year of assessment, 30 days before the beginning of the basis period for that year of assessment.

In practice, the IRB has considered applications (via Form CP204) which are submitted with a lower tax estimate than the permitted amount (i.e. 85% of the revised or original estimate of tax payable for the immediately preceding year of assessment) provided the Form is accompanied with an appeal letter with valid reasons and supporting documents. Such cases are considered based on the merit of each case and are thus subjectively determined.

Proposal

The Institute proposes that Section 107C of the Income Tax Act, 1967 (the Act) be amended to specifically allow a company with valid reasons to file a tax estimate which is lower than the permitted amount so as to reduce its financial burden.

4.4 Refund of tax overpayment

Following the submission of the initial tax estimate as stated above, a company may revise the estimate of tax payable in the 6th and 9th month of the basis period and in the event that actual tax payable exceeds the estimated tax by an amount of more than 30% of the actual tax payable, the company shall be liable to a penalty of 10% on the difference. Due to this requirement, some taxpayers tend to furnish a higher estimate of tax payable to avoid a penalty being imposed. As a result, some taxpayers will have overpaid their taxes.

Under the Act, penalties are imposed on the taxpayers for late payment of taxes so as to encourage taxpayers to settle their tax liability on a timely basis and also as a form of compensation for the Government due to late collection of taxes. Having regard to this, we suggest that taxpayers should also be compensated for the loss of use of funds due to a delay in the refund of tax overpayment. It is noted that steps have been taken by the IRB to speed up the refund and this is welcomed. It must be appreciated that in some of the cases, the amount of tax overpayment is substantial and any delay in the refund will affect the taxpayer’s cash flow as well as lead to a loss of profit in view of the opportunity cost associated with the money withheld by the IRB.

Proposal

In view of the above, it is proposed that any tax overpayment due to a taxpayer should automatically be used to set off the taxpayer's current year tax liability unless a refund application has been made. A penalty should not be imposed if sufficient tax credits are available. Where a tax overpayment is not refunded within a period of 60 days, there should be an increase in the total amount of tax to be refunded, perhaps at the same rate of increase as that imposed on taxpayers for a delay in the payment of tax.

4.5 Submission of income tax return for employees

Every employer is required to deduct (where required), the monthly tax deductions from the remuneration of each of his employees based on the Income Tax (Deduction from Remuneration) Rules 1994.

Proposal

To further simplify the self-assessment system, the Institute would like to propose that all individual taxpayers who are currently employed and subjected to schedular tax deductions, be waived from the requirement to submit personal tax returns. In view of the fact that tax deductions are being deducted from their salary every month, they should only be required to submit a tax return where there is an overpayment of tax or if the individual has other income to report. At the same time, the schedular tax deductions tables need to be reviewed to ensure that the deductions to be made are accurate.

4.6 Tax audits and investigations

The Institute commends the Government's move to issue the tax audit and investigation framework. The frameworks should be adhered to closely by both the IRB officers, tax agents and taxpayers to ensure a successful implementation of the frameworks. The conduct of tax audits and investigations must be in line with respecting the rights of all parties.

Proposal

A clear mechanism must also be set in place for any appeal against the manner in which an audit/investigation is carried out and such appeals could be settled on a timely basis by an independent party, for example, an Administrative Appeals Tribunal (AAT).

The Institute also wishes to highlight the following matter in relation to the framework for tax investigation:-

Paragraph 12.6 reads as follows:-

"Where a taxpayer seeks a longer installment payment scheme than usually permitted, the penalties exigible will be much higher compared with a taxpayer who opts to settle in one lump sum payment or requests for an installment payment scheme of a shorter duration"

Proposal

A penalty should not be increased due to a longer installment scheme. A taxpayer should not be penalised merely because he has applied for a longer payment scheme. Instead they should be encouraged to made full settlement and the merit of a case should be looked into. The Institute therefore proposes that the said paragraph 12.6 be deleted.

4.7 Appeals

Where it is unlikely that the IRB and the taxpayer will reach an agreement on an area of dispute, either party can appeal to the Special Commissioners (SC). Either party to the proceedings before the SC may appeal on a question of law against the decision of the SC to the High Court. Further appeals may be made to the higher courts, subject to the provisions of the Courts of Judicature Act 1964. There are some limitations in allowing an appeal to be heard beyond the Court of Appeal.

Proposal

To improve the appeal process, the following measures are proposed:-

(a) the Courts of Judicature Act be amended to allow cases first heard by the Special Commissioners to be eventually heard at the Federal Court. This would allow taxpayers the right of appeal to the Federal Court.

(b) Review the time frame for disposal of appeals by the Director General of Inland Revenue (currently, a maximum period of 18 months is far too long and does not motivate efficient handling of appeals).

(c) Consider the setting up of an Administrative Appeals Tribunal (AAT) for taxpayers aggrieved by decisions of an administrative nature including the imposition of penalties.

(d) Provide an avenue for appeals against penalties which are imposed through the exercise of the discretionary power of the IRB. This could be through the AAT stated above.

5. Taxpayers' Rights

With the implementation of the self-assessment system, the IRB is able to place emphasis on enforcing compliance via tax audits and investigations. Compliance with the tax legislation must be strictly enforced and tax offences such as non-compliance and tax evasion should be penalised. Civil investigation is one of the measures of enforcement. Penalties imposed should commensurate with the degree of culpability of the offence. To further promote effective enforcement, criminal investigations are also being carried out by the IRB.

With widening powers being granted to the IRB, it is even more pertinent that the *rakyat* is fully aware of their rights and obligations as a taxpayer. The tax system should be clear, transparent and equitable. It is noted that the IRB has recently revised its Client's Charter.

Proposal

The following suggestions are proposed-

a) The introduction of the office of a Taxation Ombudsman as an avenue for taxpayers to forward complaints in relation to non-technical matters.

b) The introduction of an Administrative Appeals Tribunal (mentioned earlier) for taxpayers aggrieved by decisions of an administrative nature (including the imposition of penalties).

c) The establishment of a more effective Taxpayer's Charter or Client's Charter which not only sets out the rights and obligations of taxpayers and certain timelines for the IRB to follow but is also effectively monitored as far as the adherence to the Charter is concerned.

d) Criminal proceedings should only be initiated on repetitive or recalcitrant offenders and not as a first recourse of action.

6. Advance Rulings

It was proposed in the 2007 Budget to introduce advance rulings in the income tax administration. Section 138B has since been legislated with effect from 1 January 2007. The scope and procedure has been stipulated in the Income Tax (Advance Rulings) Rules 2008. It is understood that the advance rulings issued will not be published.

Proposal
We would propose that the advance rulings be published for general reference with the confidentiality of the taxpayers maintained. Countries such as Hong Kong, Canada and Australia do publish the rulings issued. This would be seen as a move by the authorities to promote transparency in the tax administration

7. Application of Decided Tax Cases

7.1 Publication of Decided Tax Cases

It is not always possible for a piece of legislation to be perfectly clear resulting in certain provisions in the Act to be the subject of dispute with the tax authorities. It is here that case law provides the opinions of the courts on the interpretation of the legislation which are relied upon by practitioners and tax officers. It is noted that the IRB adopts decisions made in cases which are still under appeal.

Proposal
The following are proposed-

a) Tax cases decided by the Special Commissioners, Customs Appeal Tribunal and courts should be made available to the public for better transparency through timely dissemination via the IRB's and Customs websites or other means. This is the practice in certain developed nations. The Special Commissioners of Income Tax and Customs Appeal Tribunal should also establish their own websites and place their judgements on these websites.
b) Taxpayers should be allowed to adopt the decisions passed by the courts (irrespective of the stage of appeal of the case) in the preparation of their tax computation in respect of the interpretation of the legislation since the IRB also applies certain decisions. There should be a level playing field. No penalty should be imposed on the taxpayer for following such court decisions.

7.2 Scope of Controlled Transfer

With regard to a controlled transfer, the IRB appears to hold the view that the controlled transfer provisions under Schedule 3 of the Income Tax Act apply only to transfers between Malaysian residents. This is not supported by the legislation nor clarified in the IRB Public Rulings. Both the Public Ruling No.1/2001 – "Ownership of Plant and Machinery for the purpose of Claiming Capital Allowances" and Public Ruling No. 2/2001 - "Computation of Initial & Annual Allowances in Respect of Plant & Machinery" do not clarify the position of controlled transfers of assets between Malaysian residents and overseas related parties. In the case of ***SEOD S.A. vs LHDN,*** both the Special Commissioners and the High Court decided that there is no requirement under the Act to require the acquirer to be a Malaysian resident for a controlled transfer to apply. The IRB takes the view that the principles established in the above case cannot apply to any other taxpayer if the facts and circumstances are not the same. This is an approach that is commonly stated by the IRB instead of applying the principle that has been established by the courts.

Proposal
It is proposed that the controlled transfer provisions under Paragraphs 38-40, Schedule 3 of the Income Tax Act be clarified so as to avoid ambiguity so that taxpayers are not made worse off in the case of controlled transfers between Malaysian residents and overseas related parties. Decision of the Courts must be applied and not restricted in its application.

8. Waiver of the Need to Gazette Tax Exemption

It has been gazetted that the 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 Institute appreciates 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.

Proposal
The Institute would suggest that the provision be withdrawn. Instead, the relevant tax authorities can be directed to accept the official letter on the exemption issued by the Ministry of Finance pending the actual gazette order.

9. Effective Use of Technology

In order to continue to collect more tax revenue (which will be essential in assisting future moves to attain a balanced budget), the need for effective enforcement by the tax agencies (both the IRB and the Customs Department) is an important component. With technology, we can do a lot to ensure that tax officers are free to concentrate on enforcement be it via audits, inspections or investigations.

Proposal
(e) It is time that the tax agencies are transformed into truly “service-oriented” entities which use information technology effectively and efficiently. It is time to stop “piecemeal” introduction of technology. There must be a holistic plan which is integrated and well-coordinated. There will be a need for the Government to budget for such expenditure but we must move along this road and it requires a holistic approach i.e. the whole agency must be wired, trained and have a service-oriented mindset. A proper and systematic approach towards implementing technology and efficient and well-trained staff will lead to a more effective and efficient tax agency. This should lead to the registration of more taxpayers, effective recovery action and thus greater tax revenue. The IRB’s website and the press should be fully utilised to convey latest policies and accurate information **instantly** to taxpayers all over the country as well as to all tax agents.

B. MAINTAINING A COMPETITIVE FISCAL ENVIRONMENT

1. Review of Income Tax Rates

Currently, an individual resident in Malaysia will hit the top tax rate of 28% once the taxable income reaches RM250,000. The tax payable for an individual with chargeable income of RM500,000 is RM124,975 in Malaysia, and S$78,700 in Singpaore, as shown below:

	Malaysian Tax (RM)	Singaporean Tax (S $)
First RM250,000	54,975	30,800
Next RM250,000	@ 28% 70,000	**@17%/20%** 47,900
Total tax payable for 500,000	124,975	78,700

This work out to an effective tax rate of around 25% in Malaysia and 15.7% in Singapore. The corporate tax rate for small and medium scale companies for the first RM500,000 is 20%, which translates to a tax payable of RM100,000. Hence, there is an additional tax payable of RM24,975 borne by the individual taxpayer compared to a small and medium scale company at the same level of chargeable income.

In comparison, a resident of Singapore will only be taxed at the rate of 17% at the same income level for year of assessment 2008. Furthermore, the top tax rate for an individual in Singapore is only 20% on income over S$320,000 for year of assessment 2008 compared to our top tax rate of 28% on income over RM250,000.

As announced in the 2008 Budget, the corporate tax rate is reduced to 26% and 25% in years of assessment 2008 and 2009 respectively. This is a progressive step. However, in view of regional developments and the need to attract FDI, more changes need to be looked into.

Proposal

The Institute wishes to propose the following:-

(a) The Government should review the tax brackets for individuals with the objective of having larger income bands and aligning these to the corporate tax rates so as to improve its competitiveness and to ease the financial burden of individuals. The tax rate for the top bracket for individuals, currently at 28%, should be streamlined with the corporate tax rate. In addition, a higher level of disposable income in the hands of taxpayers will increase consumption, thereby boosting the domestic market.

(b) The corporate tax rate should be further reduced to enhance competitiveness in attracting foreign investment. Of course, this needs to be done hand-in-hand with the shift towards a comprehensive consumption tax so that the nation's tax revenue is maintained.

2. Goods & Services Tax (GST)

The Ministry of Finance made an announcement on 22 February 2006 to defer the implementation of GST to allow businesses sufficient time to prepare for GST. Based on recommendations by the International Monetary Fund, the minimum time frame recommended for the implementation of GST is one year from the date the legislation is introduced.

Proposal

It is hoped that the draft legislation on GST will be made available for public consultation before it comes into force. It is essential that the general public, in particular businesses and traders, are adequately informed about the features of the GST and the procedural requirements before the GST legislation is effective. This is necessary to avoid unwarranted increases in prices of goods and services. A one year lead-in period from the date of announcement of the GST legislation to the effective date of implementation is important for educational campaigns and preparation for computerisation.

In addition, the Institute also hopes that guidelines/rulings on specific arrangements /administrative practices be made known to the public on a timely basis to ensure transparency and clarity in the application of the GST provisions

3. Single Tier System

Although the Single Tier System is simple and efficient, various issues and ambiguities arise in respect of the transitional provisions as outlined below.

3.1 Tax Exemption for Dividend Income

Paragraph 12B is inserted in Schedule 6 of the Income Tax Act as follows:

"Any dividend paid, credited or distributed to any person where the company paying such dividend is not entitled to deduct tax under this Act and any expenses incurred in relation to such dividend shall be disregarded for the purpose of this Act"

Proposal

The paragraph is intended to apply to all dividends whether these are a business source or an investment source. It is suggested that the paragraph should not apply to a business source as this will have an impact on financial institutions.

3.2 Cut Off Date for Accumulation of Section 108 Balance

Using 31 December 2007 as a "cut off" date for the Section 108 balance is not equitable to all companies.

Proposal

To be fair to all companies, the Institute proposes that instead of tax payments up to 31 December 2007, the actual tax liability based on the deemed assessed tax return form for the year of assessment 2007 should be credited into the Section 108 balance. All tax liabilities from the year of assessment 2008 and onward should not be allowed to be credited into the Section 108 balance. However, since for some companies, the year of assessment 2008 has already commenced, it would be more equitable to use year of assessment 2008 as the effective year rather than 31 December 2007.

3.3 Payment/Crediting of Dividends in Respect of Ordinary and Preference Shares

Based on the Finance Act 2007, the dividend imputation system will continue to apply to a Company during the transition period from 1 January 2008 to 31 December 2013 if it still has Section 108 credit and provided that the dividend is paid in cash in respect of ordinary shares. It thus follows that the imputation system would not apply to dividends paid in cash in respect of non-ordinary shares such as preference shares, redeemable preference shares (RPS), etc during the transitional period. Instead, such dividends are governed under the single-tier system.

This difference in treatment for various types of shares would result in an increased financial burden to companies which have issued preference shares, RPS or other similar types of shares before the 2008 Budget announcement. This is because the rate of dividend for such shares is usually fixed in advance at the date of issue and the rate is calculated by reference to the amount of gross dividend payable. Under the imputation system, the issuers will deduct tax from the dividends paid at the prevailing corporate tax rate and pay the net amount of dividends to the shareholders. Under the single tier system, however, the issuers of preference shares and RPS will have to pay an additional amount of cash (equivalent to the corporate tax to be deducted on the dividend under the imputation system) to their shareholders so as to fulfill their obligations to pay the same dividend rate for the shares. The following are two examples illustrating the financial impact of payment of dividends to preference shareholders under the single tier system:

Example 1

Company B has a shareholder, Company A which has subscribed for preference shares of RM100 million consisting of 100 million preference shares of RM1.00 each. Pursuant to the terms of the agreement for the subscription of the preference shares, the rate of dividend per annum payable is such that Company A will receive a fixed annual rate of return of, say, minimum 9% from Company B. The fixed annual rate of return as agreed between Company A and Company B is calculated as follows:-

Gross Preference dividend payable per annum to Company A Less: Tax Deducted (Section 108 Credit)	RM10,000,000 (2,700,000)
Net dividend payable to Company A	7,300,000

In the books of Company A

Gross Preference Dividend received Less: Interest Expense (say)	10,000,000 (7,000,000)
Chargeable Income	3,000,000
Tax Payable @ 27% Less: Section 110 set-off	810,000 (2,700,000)
Tax Refundable by IRB	(1,890,000)
Total cash received (RM7,300,000 + RM1,890,000)	9,190,000
Annual Rate of Return on preference shares (RM 9,190,000) (RM100,000,000)	9.19%

Company B will have to pay a higher preference dividend of RM9,000,000 so that Company A will still receive a minimum annual rate of return of 9% from Company B. The annual cash outflow for Company B will increase by RM1.7 million.

Example 2

Under the Finance Act 2007, a company may pay franked dividends during the transitional period from 1 January 2008 to 31 December 2013 if it has a Section 108 balance provided the dividend is in the form of cash and is in respect of ordinary shareholdings.

As such, payment of dividends in respect of preference shares can only be made under the single-tier system or out of the company's tax exempt account (if any) and not out of the company's Section 108 credit. This would increase the cost to the company in paying dividends to preference shareholders, as illustrated below.

Company A issued 100,000 preference shares of RM1 each with the following terms:

- A fixed cumulative preferential dividend of 2% per annum payable out of the profits of the Company;
- The return of paid-up capital on winding-up in priority to the ordinary shares; and
- The Directors of the company shall be entitled at any time to redeem all or any of the preference shares at par value or at such premium as the Directors shall determine.

	Dividend paid under imputation system RM		Dividend paid under single-tier system RM
Gross dividend of 2%	2,000		2,000
Less: Tax on dividend @26%	(520)		-
Net dividend paid	1,480		2,000

Based on the above scenario, under the single-tier system, the cash outflow of the company on payment of the dividend is now RM2,000 as compared to RM1,480 under the imputation system.

Proposal

In view of the above two examples, the Institute would like to propose that the amendment to the law should only be applied to those companies which issue preference shares after Budget day (i.e. 7 September 2007) so that companies which have issued preference shares, RPS and other non-ordinary shares before 7 September 2007 will not be burdened with the additional financial costs. This will thus avoid the retrospective impact of the provisions.

In addition, the Institute also wishes to highlight that dividends declared and paid to a company's shareholders by setting off against inter-company accounts should also be regarded as dividends paid in cash.

3.4 Additions to the Section 108 Balance until 31 December 2013

Based on the Finance Act 2007, where the tax paid by a company which has been taken into account for computing its Section 108 balance is refunded during the period from the first day of the basis period for Year of Assessment 2008 to 31 December 2013, the company's Section 108 balance shall be reduced by the amount refunded.

There is no corresponding increase to the company's Section 108 balance, however, where the tax paid by the company which has been taken into account for computing its Section 108 balance is increased, for example, by the issuance of an additional assessment during the aforesaid period.

Proposal

The Institute is of the view that on the grounds of justice and equity, there ought to be a corresponding increase to a company's Section 108 balance in the circumstances stated in above, i.e. in the event of tax paid due to the issuance of an additional assessment during the aforesaid transitional period. The company should then be allowed to utilise its revised Section 108 balance that has been increased which shall be disregarded if not utilised in part or in full as at 31 December 2013.

3.5 Election for non-utilisation of Section 108 credits

Sections 49 & 50 of the Savings and Transitional Provisions (Finance Act 2007) provide for a company to exercise an irrevocable option to disregard the Section 108 balance. As a result of the election, the company will not be entitled to deduct tax against future dividend payments.

In a case where the election has been exercised, it is not clear whether the company could still use the Section 108 balance when a reduced assessment relating to an assessment prior to YA 2008 is issued during the 6-year transitional period. The reduced assessment will result in a shortfall and thus a debt due and payable by the company. If the Section 108 balance is still available, then the Section 108 balance will lower the amount of shortfall which is due and payable as shown below:

Example :

(i) If the Section 108 balance is allowed to be utilised despite the election

	RM	
Section 108 balance at 31.12.2007	400,000	(election exercised in 2008)
Form JR 2006 issued in 2010	600,000	
Amount of shortfall	(200,000)	

(ii) If the Section 108 balance is not allowed to be utilised because of the election

	RM
Section 108 balance	Nil
Form JR 2006 issued in 2010	600,000
Amount of shortfall	(600,000)

Proposal

It is agreed that if an election is made, then the Section108 balance will not be available for future franking of dividends. However, it is proposed that the Section 108 balance be available for reducing any requisition that may arise during the 6-year transitional period. This should be made clear in the legislation.

4. STD payments for expatriates working at an OHQ /RO /RDC /IPC

Currently expatriates working at an OHQ /RO /RDC /IPC qualify for the income tax exemption depending on the length of stay in Malaysia. However, this will be known only after the year end. Meanwhile, the employers have to continue to deduct STD payments based on the normal provision.

Proposal

The Institute would like to propose that where there is a specific basis for ascertaining the length of stay in Malaysia fairly accurately, a concession be allowed to lower the STD payment accordingly. This is to reduce the administrative burden for both parties, i.e. deducting tax and then claiming a refund for the overpayment.

5. Review of Fiscal Incentives

Competing for FDI has become an important focus in the fiscal policy of many developing countries. It is noted that many of our neighbouring countries competing for FDI also grant incentives similar to our pioneer status and investment tax allowance (PS & ITA).

Proposal

To further differentiate ourselves from our competitors, the Institute proposes that

(a) Malaysia gradually moves away from PS & ITA and adopt a system of according preferential tax rates for promoted industries/products over a fixed period of time. Extension of the period could be based on reinvestment or other criteria met by the company.

(b) The preferential tax rates should be minimal and be set at the level which is sufficient to compensate for the usage of public infrastructure.

(c) This would simplify the compliance process and reduce compliance costs as both the taxpayer and IRB are relieved from the need to comply with/monitor compliance with the specific provisions under the PIA.

(d) The transformation to this proposed simpler system is also in line with the country's move to the single tier tax system as well as the shift from direct to indirect tax with the eventual implementation of GST.

Alternatively,

(a) Malaysia may continue to provide PS & ITA for the specific periods but after the expiry of the incentive, a lower income tax rate should be granted for a specific period before the existing corporate tax rate comes into play. This would promote long term presence of FDI and encourage reinvestment. This will thus avoid the difficulty or concern that an investor will have from transitioning from a nil or 7.5% effective tax rate to a 25% tax rate.

(b) In this connection, any offering of new incentives should be targeted at promoting the long term betterment of Malaysia's economy rather than achieving a knee jerk impact that provides investors and the country with short term gains only.

(c) The provision of incentives should not be solely targeted at attracting FDIs but should also promote investment/reinvestment by the local small and medium industries which have been identified as one of the drivers for sustainable economic growth.

C. CONTINUOUS REVIEW IN ENSURING AN EQUITABLE AND BUSINESS FRIENDLY TAXATION SYSTEM

1. Convergence between Accounting and Taxable Profits

Over the years, accounting standards have undergone fundamental changes so as to fairly reflect business transactions and the underlying economic reality in the modern business environment, both domestically and globally. This is evidenced by the issuance of Financial Reporting Standards (FRS) in Malaysia.

All companies, other than private entities, are required to adopt the FRS released by the Malaysian Accounting Standards Board which are in line with the International Financial Reporting Standards with the exception of FRS 139 (Financial Instruments: Recognition and Measurement) which has been postponed indefinitely. The adoption of the FRS results in changes in accounting treatment which impact the net profit of an entity. With such changes, there is a need to also review the tax impact of such adjustments and to determine whether the tax treatment of certain transactions should be changed or modified. This is even more important in the context of self-assessment. The adoption of the FRS is a move towards fair value accounting which would affect taxation.

Singapore companies were required to adopt the FRS with effect from 1 January 2005. Following this, in December 2005, the Inland Revenue of Authority of Singapore (IRAS) released a guideline on the Income Tax Implications Arising from the Adoption of the FRS on Financial Instruments: Recognition & Measurement which explains the changes to the treatment of financial assets and liabilities for income tax purposes.

However, the Malaysian tax legislation has not kept pace with these changes. In order to facilitate tax administration and reduce the cost of tax compliance under the self assessment system, the principles of recognition of profit and expenditure under the revenue laws should converge with the principles prescribed in the FRS. This convergence would overcome the problem of mismatching that arises from different accounting and tax treatment for specific items (whether income or expenditure).

Proposal

A working group should be formed between IRB, MOF, the Malaysian Institute of Taxation and any other relevant organizations to address the issues to ensure a greater convergence between tax and accounting.

Some examples of accrual of income/expenses as provided for under the FRS which should be adopted for tax purposes are listed below

Interest receivable should be taxed on an accrual basis in the year in which it is accrued as required under the accounting standards rather than be taxed in the year it is received. Receipt of advance rental income for a period of say, five years which will be spread evenly throughout the said period of time (according to the accounting standard) should be taxed according to the accrual basis instead of taxing it in advance when it is received.

As for the taxability of the 5% retention sum retained under construction contracts, the amount so withheld during the warranty period should be treated as deferred income to be set off against expenses incurred during the warranty period. Therefore, it should be brought to tax after the warranty period so that the income and expenditure can be matched.

2. GST Implementation Costs

In view of the implementation of GST in the near future, businesses would need to incur additional expenditure to ensure that their current management and business information systems are adequately modified to account for GST. The employees would also need to be trained to understand the workings and mechanism of GST.

Proposal

It is proposed that the legislation be specifically amended to allow the deduction of the expenditure incurred by taxpayers for the purpose of enhancing or improving their operating systems, training their workforce, etc in preparation for GST.

3. Withholding Tax under Section 109B

The scope of Section 109B of the Act and the types of payments that would be subjected to withholding taxes under this provision have been controversial issues. The IRB takes the view that payments which form part of the contract value for the services rendered by a non-resident amount to income within the meaning of Section 4A of the Income Tax Act 1967. As a result, withholding tax is applicable on a wide range of payments made to non-residents including the disbursements made to non-residents, e.g. travelling and accommodation costs etc., even where such costs are borne directly by the payer. Based on the Public Ruling No.4/2005: Withholding Tax on Special Classes of Income, disbursements or reimbursements of out of pocket expenses incurred in the course of rendering services to the non-resident are subject to withholding tax. Taxpayers are advised to pay the withholding tax first to the IRB and subsequently attempt to recover the sum from the non-resident. In practice, most taxpayers end up bearing the withholding tax themselves. This thus increases the cost of operations and affects competitiveness.

Such an interpretation has not been well received both locally and internationally The Royal Customs Department Malaysia has stated (on page 50 of its "Service Tax Procedures" booklet published in 1992) that:

"*Disbursements or out-of-pocket expenses are costs necessarily incurred in order that the relevant service may be communicated, transmitted or delivered to the client……and such costs are distinct from the professional fees charged for the actual service itself."*

The booklet went on to explain that accordingly reimbursements are not subject to service tax. There are also a number of foreign decided cases which held that reimbursements and disbursements do not have the character of income.

The Institute is of the view that certain expenses payable to non-residents (e.g. management and administrative fees) and reimbursements of costs made to non-residents should not fall within the ambit of Section 109B(1)(b) and be subjected to withholding tax. Strictly, payments of out-of-pocket expenses to non-residents reflect a settlement of debts incurred by the non-residents in connection with the services provided under Section 109B and are not payment for such services provided per se. It would not be equitable for the IRB to compel residents to deduct withholding tax on the out-of-pocket expenses on the basis of potential abuse and tax evasion as the charging of out-of pocket expenses by the non-residents can be supported by documentary evidence such as receipts, invoices, etc.

Proposal

Section 109B should be amended to provide that reimbursements/disbursements are not subject to withholding tax. This will help to reduce the cost of doing business in Malaysia.

4. Harmonisation of Capital Allowances and Depreciation

Under the current tax system, deductions are not allowed for capital expenditure or for depreciation of assets used in the production of gross income. Accounting depreciation is not recognised as a tax deductible expense as it is merely a write off of the cost of a fixed asset over its estimated useful life and the rate of depreciation applied varies from company to company depending on the circumstances.

The Act however, provides for tax depreciation or deduction of capital expenditure for certain types of capital expenditure in the form of capital allowances. The capital allowance rates are fixed based on the type of asset. However, the rates of accounting depreciation and capital allowances are often not the same and would require recomputation for tax purposes. Under the 2006 Budget, qualifying expenditure on small value assets (capped to RM10,000) is now given 100% capital allowance. However, this review of tax treatment does not bring with it the expected simplification effect – companies still need to keep track of the individual asset items leading to higher compliance costs in monitoring the movement of the small value assets and the administrative work in preparing tax computations is increased even further than before.

The adoption of FRS will also bring with it valuation of assets based on fair values. Reliance would be placed on third party valuation in estimating the fair value of the assets.

Proposal

The following are proposed-

(a) small value assets should be given an outright revenue deduction instead of a 100% capital allowance claim as such assets have no economic value in the future and if there is any sale proceeds for such assets, these will be subjected to tax when sold. It is reiterated that this is fundamentally a timing difference.

(b) the cap for small value assets should be increased from the current value of RM 10,000 to allow for companies which have a number of small value assets which would easily exceed the current limit. It also allows for greater efficiency and reduces the administrative burden in identifying and tracking the assets.

5. Capital Allowances and Rental Claims on Private Motor Vehicles

Currently, a company that purchases private motor vehicles for its business and a leasing company that leases out private motor vehicles may claim initial allowances (20%) and annual allowances (20%) on private motor vehicles up to a limit of RM100,000, if the cost of the vehicle is less than RM150,000. If the cost of the motor vehicle is more than RM150,000, the qualifying expenditure for the capital allowance claims is limited to RM50,000.

Similarly, for a lessee of a private motor vehicle, the maximum deductible rental expense is RM100,000 per vehicle provided that the cost of the vehicle is less than RM150,000. If the condition is not fulfilled, then the claim is limited to RM50,000.

The limit of capital allowances and rental claims on the private motor vehicles should be reviewed as in most instances the cost of a private motor vehicle is more than RM150,000 and the tax relief is only limited to RM50,000 per vehicle.

Following the 2007 Budget, it has been legislated that any amount of debt released in respect of expenditure on which capital allowances have been claimed previously shall now be taxed. This is irrespective of whether the capital allowances were claimed in full or otherwise.

Proposal

It is proposed that the limit on qualifying expenditure for capital allowances and lease rental claims on private motor vehicles be removed. Alternatively, it could be increased to reflect the current economic environment.

The cap (if necessary) may be considered for motor vehicles based on its cylinder capacity. For example, motor vehicles with cylinder capacity lower than 2,000 cc should have no restriction on capital allowances claimed while those with cylinder capacity greater than 2,000 cc could have a limit on the capital allowances claimed, say up to RM250,000.

6. Deduction of Recurring Compliance Expenditure

In order to ensure compliance with statutory requirements set out by specific legislation or by regulatory authorities, companies necessarily incur expenses such as audit fees, tax agent's fees, secretarial fees, annual listing fees and other compliance/governance-related expenses.

The *Income Tax (Deduction for Audit Expenditure) Rules 2006* provides that statutory audit fees incurred by companies are allowable expenses with effect from year of assessment 2006. This raised doubts as to whether other recurring compliance expenditure such as tax agent's fees, secretarial fees, etc will continue to be deductible. In the PR 6/2006 Tax Treatment of Legal & Professional Expenses, it has been indicated that costs of filing income tax returns and computations and secretarial fees are not deductible from year of assessment 2006.

It is highlighted that the Companies Act 1965 requires a company to appoint a company secretary. Notwithstanding that tax agents are not required to be appointed by companies under any law, the role of these parties (i.e. company secretaries and tax agents) are essential to the operation and administration of businesses. The expenses incurred are recurring costs in operating a business as secretarial matters and tax matters arise in the course of a financial year. In addition, the Institute would like to highlight that salaries paid to such professionals for example, a qualified tax manager and company secretary who are employed by the organisations (in house services instead of services being outsourced) would be fully deductible as staff/salary costs. In reality, to achieve cost efficiency and to minimise the internal operational cost, most organisations will outsource such services.

In New Zealand, it is specifically legislated that a person is allowed a deduction for expenditure incurred in connection with matters relating to calculating or determining the income tax liability. Countries such as United Kingdom, Canada, Ireland and Hong Kong allow the deduction of such expenses under the general deduction provision in their respective legislation. In Australia, business taxpayers rely on the general deduction provision whilst individual taxpayer can rely on a specific legislative provision.

Proposal

As these recurring compliance fees such as tax agent's fees, secretarial fees and annual listing fees are expended in the course of an on-going business, it is proposed that

(a) Such expenses be legislated as specific deductions to recognise business realities as such expenses are essential in operating a business. With the constant evolution of the tax administration, from the official assessment to self-assessment, it can no longer be said that a company only fulfills its tax obligation after the year-end.

(b) In the absence of a specific amendment or a gazette order, the Institutes would suggest to MOF/IRB to exercise their discretion to allow a concessional tax deduction on the above-stated expenses on the basis that those expenses are required to be incurred by companies due to the statutory and corporate governance requirements that have been enacted by the Government itself.

7. Deduction for Cost of Acquisition of Proprietary Rights

Pursuant to *the Income Tax (Deduction for Cost of Acquisition of Proprietary Rights) Rules 2002*, among others, the cost of acquisition of proprietary rights such as patents, industrial designs and trademarks may be claimed over five years of assessment by a manufacturing company which has incurred the same or by the manufacturing company's subsidiary if the proprietary rights are transferred to the latter.

However, the Government has not introduced any incentive to encourage the acquisition of intellectual property in the non-manufacturing sectors. The criteria to allow only the manufacturing sector this deduction is too restrictive as on occasions, a holding company, which is a non-manufacturing concern, may incur cost on the acquisition of proprietary rights.

Proposal
It is proposed that the incentive to allow only manufacturing companies to claim the cost of acquiring proprietary rights be extended to all companies to encourage these companies to acquire new technologies to evolve into innovation-driven, knowledge-based companies. The incentive should also cover new business where the intellectual property was created or acquired prior to the commencement of business.

8. Tax Treatment of Advance Payments/Prepayments

Currently, there is no specific provision in the Act on the taxation of advance payments/prepayments received except where it relates to interest and rental income. Therefore, general provisions within the Act are relied upon for guidance on the recognition and taxation of such income.

Section 24(1) of the Act has some relevance on the timing of taxability of advance payments. This section provides that:-

"Where in the relevant period a debt owing to the relevant person arises in respect of
(a) any stock in trade sold (or parted with on requisition or compulsory acquisition or in a similar manner) in or before the relevant period in the course of carrying on a business;
(b) any services rendered at any time in the course of carrying on a business; or
(c) the use or enjoyment of any property dealt with at any time in the course of carrying on a business,

the amount of the debt shall be treated as gross income of the relevant person from the business for the relevant period."

From the ordinary reading of this section, there must be services rendered or actual use and enjoyment of the facilities in order for the incidence of taxation to arise. This accords with the common law principle embodied in Section 3 of the Act that income is taxable where it has accrued in or derived from Malaysia – in other words, income is taxable when it has been "earned".

Prepayments or advance payments should not be subject to tax in the year of receipt. They should only be deemed received or receivable in the year they accrue i.e. in the year they fall due. The prepayments should be taxed only when the amount has been earned or derived, which is not at the point of receipt, but rather, through the effluxion of time. The prepayments do not constitute gross income in the year of receipt as the amount has not been derived and no "debt" under Section 24(1) of the Act arises at the point of receipt.

The taxation of prepayments in the year of receipt would result in a gross mismatch of income and expenses. In this regard, the upfront fees would not match the expenditure (e.g. repairs and maintenance) in future years. This is a most inequitable tax position.

Proposal
It is proposed that an appropriate provision be introduced to tax advance payments/ prepayments as and when they fall due. This converges with the accounting method of recognising such income in the accounts. Prepayments should not be taxable until they fall

due each year as the debt for the prepayments has not arisen until the payments fall due each year.

9. Entertainment Expenses

Following the 2004 budget announcement, Section 39(1)(*l*) of the Act was amended as follows:

"a sum equal to fifty percent of any expenses incurred in the provision of entertainment including any sums paid to an employee of that person for the purpose of defraying expenses incurred by that employee in the provision of entertainment."

The Institutes welcome the amendment to the said legislation. However, the amendment has led to disputes due to different views and interpretations on the said section despite the guidance provided in the Public Ruling 3/2004: Entertainment Expenses. As a result, a lot of issues/problems have arisen and the public ruling is unable to address all the issues faced in reality. There are a number of restrictions imposed before an entertainment expense is allowed for deduction as provided in the said public ruling. As defined under Paragraph 3.2 of the ruling, "entertainment related wholly to sales" means the entertainment which is directly related to sales provided to customers, dealers and distributors excluding suppliers. In interpreting Paragraph 3.2 above and Paragraph 6.7 on the provision of entertainment related wholly to sales arising from the business, the Institutes are of the view that entertainment of clients, whether new or existing, should be wholly deductible (instead of a 50% deduction being allowed for existing clients) so long as the expense is incurred in the provision of entertainment and is directly related to attempting to generate sales.

The Institute would like to highlight that entertainment of all (both potential and existing) customers is part of a company's business activity to secure business and sales and segregation between entertainment of potential and existing clients would prove commercially and administratively impractical.

Proposal

To ease the administrative work in preparing tax computations and to promote simplicity in tax compliance under the self assessment system, the Institute propose that any expenses incurred in the provision of entertainment should be partially allowed as a deduction against the gross income while entertainment expenses which fall under Section 39(1)(*l*)(i) to (vii) of the Act should be allowed in full as a deduction to arrive at the adjusted income.

10. Confirmation of Tax Exempt Account

Section 21(3) of the Promotion of Investments Act, 1986 (PIA) requires the exempt income of a pioneer company to be confirmed by the IRB before the company can distribute tax exempt dividends to its shareholders. This leads to the pioneer companies not being able to declare tax exempt dividends if their tax computations have not been reviewed by the IRB. This has caused undue hardship to the companies concerned, which need to distribute dividends on a regular basis to shareholders.

Although the Act has been amended to put into force the self assessment system, there is no corresponding amendment to the PIA on the procedures for payment of tax exempt dividends.

Proposal

It is proposed that a suitable amendment be made to the PIA to dispense with the above requirement for confirmation from the IRB in line with the self-assessment system. The Institute believes that steps are being taken to introduce an amendment.

11. Formula Based Provisions

It is proposed that the tax legislation be simplified with the removal of formula-based provisions. Examples of some of these formula-based provisions are as follows:-

(a) Paragraph 2(1)(b) of Schedule 3 provides that expenditure incurred on preparing, cutting, tunneling or leveling land in order to prepare a site for installation of machinery or plant if the expenditure exceeds 10% of the aggregate does not qualify as capital expenditure incurred on machinery or plant unless the expenditure qualifies under paragraph 67 i.e. if the expenditure amounts to more than 75% of the aggregate. The application of such a formula/approach can leave certain expenditure being not qualifying at all.

(b) Paragraph 66 of Schedule 3 provides that where the capital expenditure incurred on the part of the building/extension not used as an industrial building is not more than 10% of the capital expenditure incurred on the whole building, then that part of the building/extension can be treated as an industrial building.

12. Tax on Interest Income Earned by Associations

Many associations (including trade associations) raise scholarship and medical funds to provide assistance to its members. These are positive signs of contribution to assist individuals to enhance the quality of life. These funds are usually kept in fixed deposits at local banks and the interest income derived will be subject to tax at the relevant tax rates applicable to the association.

Proposal

To encourage these associations to continue to play a pro-active role, it is proposed that the scope of Section 109C of the Act be extended to include associations i.e. interest income earned would be subject to a 5% final tax instead of subjecting the interest income to tax at the relevant rates applicable to such associations.

13. Waiver of Debt

Section 30(4) of the Income Tax Act 1967 provides that where a deduction has been taken in computing the adjusted income of a person from a business and the debt in respect of such expense is subsequently released, the amount that is released shall be treated as gross income from that business in the year it is released.

However, there is no equivalent provision for the release of a debt in respect of an expense that is deducted from non-business sources of income. For example, if bank interest had been claimed as a deduction against dividend income and the interest is subsequently waived by the bank, the Act is silent on whether the amount waived is chargeable to tax.

Proposal

It is proposed that a provision similar to section 30(4) be introduced to address this anomaly. The proposed provision will ensure there is clarity and certainty in the tax treatment for non-business cases where a debt in respect of an expense claimed under section 33(1) has been waived.

14. Schedule 3 Allowances

14.1 Forest Allowances

It is provided in Paragraph (2), Schedule 3 of the Income Tax Act 1967 that “forest” in relation to a person, means a forest in respect of which he has a concession or a licence to extract timber therefrom, being a forest in use by him for the extraction of timber therefrom for the purposes of a business of his which consists wholly or partly of that extraction

Based on this definition, it appears that only the timber concession holder can claim forest allowances. However, in practice, the concession holder could be a statutory body which does not incur capital expenditure like roads or buildings used as living accommodation for the workers in the forest. Such capital expenditure would be incurred by the logging contractor but he would not be able to claim forest allowances because he is not the concession holder.

Proposal

The Institute proposes that the definition of "forest" be amended to allow the logging contractor to claim forest allowances on the qualifying capital expenditure on roads and relevant buildings. By virtue of the logging contract, the logging contractor is given the permit to log the trees. The law should be amended to treat such permits as a "licence" to extract timber. Capital expenditure on roads and relevant buildings form a huge part of the operating costs of a logging contractor. Moreover, in the above situation neither the concession holder nor the logging contractor can claim the forest allowances.

14.2 Agriculture Allowances and Controlled Transfers

Paragraph 38, Schedule 3 of the Act states that control transfer provisions apply to a person who disposes of an asset for which agricultural allowances have been made. However, it is noted that the Income Tax (Capital Allowances and Charges) Rules 1969 do not reflect similar "privileges” accorded to a person who has claimed agricultural allowances as compared to those who have claimed capital allowances (annual or initial allowance)

Paragraphs 26 and 27 Schedule 3 of the Act state that an agriculture charge arises if a grant is received from the Government, State Government or statutory authority or a disposal of the asset takes place within 6 years after the day it was incurred. Paragraph 10 of the Income Tax (Capital Allowances and Charges) Rules 1969 (the Rules) only prescribes the manner in which the disposer's residual expenditure on the first day of the disposer's final period is determined, and the amount of qualifying agriculture (formerly, "plantation") expenditure deemed incurred by the acquirer for the purposes of paragraph 39 of Schedule 3. Paragraph 10 of the Rules, however, is silent on agriculture charge. Further, paragraph 7 of the Rules states that no balancing allowance or balancing charge arises in a disposal except to which paragraph 6 applies i.e. in a disposal of assets. There is no mention of agriculture charge in paragraph 7. This means, in a controlled transfer situation agriculture charge will have to be imposed.

In addition, the Income Tax (Capital Allowances and Charges) Rules 1969 needs to be updated as it uses the term "plantation expenditure" which is now no longer used.

Proposal

The Institute proposes that the Income Tax (Capital Allowances and Charges) Rules 1969 needs to be updated to ensure that an agriculture charge does not arise under a controlled transfer situation and replace the word "plantation expenditure" wherever it appears with "agriculture expenditure". The Rules also need to be amended to accord a similar treatment as for those claiming initial and annual allowance for qualifying capital expenditure in the case of controlled transfers of agricultural assets.

14.3 Enhancing Security Control of Goods

To encourage companies to install security and surveillance equipment, Accelerated Capital Allowance (ACA) is now given on the expenses incurred for:

(i) security control equipment installed in the factory premises of companies approved under the Industrial Coordination Act 1975; and

(ii) vehicle surveillance equipment installed in the container lorries bearing Carrier License A and general cargo lorries bearing Carrier License A and C.

The ACA is to be fully written off within a period of one year with an initial allowance of 20% and an annual allowance of 80%. The eligible security and surveillance equipment shall be determined by the Minister of Finance.

Proposal

The Institute would like to point out that, it is not only factory premises that would require the security control and surveillance equipment to enhance the security control of goods, but all other premises that are used for storage of goods. As such, the Institute would like to recommend that the incentive should be also applicable to all other premises so long as the equipment acquired are used for the enhancement of the security control of goods.

The Institute also wishes to propose that the above incentive should be applied to all equipment which is installed for security and surveillance purposes, whether in a factory environment or an office environment.

15. Building Allowances on Non-Industrial Buildings

Based on FRS 116: Property, Plant and Equipment, buildings have a limited useful life and therefore, are depreciable assets. However, currently, only buildings used in specific sectors qualify for Building Allowances. Industrial buildings such as a factory, warehouse, dock, wharf, jetty, public road, old folks care centre, building occupied by MSC status company, etc qualify for Industrial Building Allowance, whereas workers quarter, childcare facilities, school and educational institution qualify for Special Building Allowances. There is no relief accorded to capital expenditure incurred on commercial buildings, office complex, private medical clinic, private dental clinic and other healthcare facilities, etc.

With the services sector continuing to play a major role in the Malaysian economy, capital expenditure on buildings such as schools, educational institutions, research laboratories, offices, service centres, will become a major investment cost. It is therefore pertinent that steps be taken to reduce the cost of doing business and to enhance the process of transforming the Malaysian economy towards a service-intensive economy.

(a) Alteration or renovation of new office premises is often necessary to make it suitable for the business operation. Periodic renovation and refurbishment of existing office premises is also necessary to maintain an effective and comfortable work environment for the employees.

Where the capital expenditure incurred on the construction of that part of the industrial building which is not used as such is not more than one-tenth (10%) of the total capital expenditure incurred on constructing the whole building or extension, the building or extension shall be treated as an industrial building. This means that if the extension to an office building within an industrial building is more than one tenth of the total extension, that portion relating to the office building is not considered as an industrial building.

(b) The Private Healthcare Facilities and Service Act, 1998 ("PHFS Act") which was gazetted on 1 May 2006 requires the private medical clinic, private dental clinic and other healthcare facilities provider to register with the Ministry of Health ("MOH") as a certified healthcare facilities provider. This is to ensure that the services provided by the private healthcare providers are organisationally, administratively and physically comply with the prescribed standard and requirements set by the MOH.

Pursuant to Paragraph 37A of Schedule 3 of the Income Tax Act 1967 ("the Act"), only capital expenditure incurred on the premises used for the purposes of carrying therein a private hospital, maternity home and nursing home registered with MOH would be eligible to claim industrial building allowances. This does not include the premises used for the purpose of carrying out other healthcare facilities, e.g. private medical clinic, private dental clinic, etc.

(c) Only operators of schools and educational institutions who construct or purchase buildings for the use as schools or educational institutions are eligible to claim the special building allowance equivalent of one-tenth of the qualifying expenditure on the building under Paragraph 42B, Schedule 3 of the Income Tax Act 1967.

Although the private sector has been encouraged to invest in the service sector, many potential operators do not have the resources to finance the initial capital outlay. In the case of education and training sector, there are instances where educational institutions sold their buildings to real estate investment trusts (REITS) to free them from heavy borrowings and concentrate on educational development. The acquirers (e.g. REIT) should therefore be eligible to claim the building allowance on the cost of the building acquired as a deduction against the income from the leasing of the building back to the educational institutions.

Proposal

The Institute would therefore propose that

(a) Building allowances be accorded to capital expenditure expended on all buildings, which are incurred solely and exclusively for the purpose of a business. This will provide relief for the costs incurred by businesses as well as simplify the computation of industrial building allowances where a portion of an industrial building is not so used. It also will help to boost the property market. This is in line with accounting treatment of depreciating buildings and thus provide for further convergence between accounting and tax treatment.

(b) Eligibility to claim for building allowances be extended to the owners or lessors of non-industrial buildings.

(c) Building allowances are allowed on cost of renovation and alteration on all buildings except for residential buildings.

D. STIMULATING THE BUSINESS ENVIRONMENT

1. Group Relief

Section 44A was introduced via the Finance Act 2005 (2006 Budget) to provide for group relief for tax losses whereby a surrendering company may surrender not more than 50% of its adjusted loss in the basis period for a year of assessment to one or more related companies resident and incorporated in Malaysia in the basis period for that year of assessment. The conditions to qualify for group relief are also extremely stringent and this makes it difficult for claimant companies to benefit from the group relief. Among the conditions imposed is that the shareholding of the claimant and surrendering companies in the group, whether direct or indirect, must not be less than 70%. This condition hinders a lot of companies from enjoying the group relief as the indirect shareholding interest could result in an interest below the 70% level.

As a consequence, Schedule 4C which allows a surrendering company to surrender its adjusted loss, in full or in part, in the basis period for a year of assessment in respect of an approved food production project to one or more related companies resident in Malaysia in the basis period for that year of assessment, is deleted with effect from year of assessment 2006.

Apart from food production companies, other companies engaged in forest plantations, biotechnology, nanotechnology, optics and photonics were also allowed to surrender 100% of their losses to the claimant companies.

As a result of the introduction of group relief for 50% of tax losses for companies in all sectors, the previous 100% relief available to companies engaged in food production, forest plantations, biotechnology, nanotechnology, optics and photonics is now no longer available to new companies engaged in such sectors.

Proposal

The Institute proposes that group relief be given to companies that fall under the definition of related companies as provided under the Companies Act, 1965 and the restriction of a 70% shareholding be removed. In addition, it is proposed that the losses to be allowed should be restricted only by the aggregate income of the claimant company (and not limited to only 50% being surrendered).

2. Unutilised Tax Losses and Unabsorbed Capital Allowances (Section 44 and Paragraph 75A of Schedule 3 of the Act)

Following the 2006 Budget proposal, it has been legislated that unutilised business losses and unabsorbed capital allowances shall not be carried forward to future years of assessment for deduction if the shareholders of that company on the last day of the basis period for that year of assessment were not substantially the same as the shareholder of the company on the first day of the basis period for the year of assessment.

It is further defined that the shareholders are substantially the same if on both those dates

(a) more than 50% of the paid up capital in respect of the ordinary shares of the company is held by or on behalf of the same persons and

(b) more than 50% of the nominal value of the allotted shares in respect of the ordinary shares in the company is held by or on behalf of the same persons.

With this, companies with tax losses and unabsorbed capital allowances would lose its value to potential purchasers. It would deter internal restructuring of a group of companies to achieve greater efficiency and hinder a genuine turn-around exercise to rescue a loss-making company. Eventually, this will not only bring negative impact to our economy but may also discourage foreign investors to invest in our country. Furthermore, minority shareholders will lose out on the value of the investment for something that they cannot control. As provided under Section 44(5D) of the Act, the Minister may, under special circumstances, exempt that company from the continuity of ownership test.

According to the clarification from the Ministry of Finance (MOF) in 2006, as long as there is no substantial change in the **ultimate shareholder**, the unutilised losses and capital allowances shall be allowed to be carried forward. The clarification also states the special circumstances for exemption include (1) privatisation of a government entity, (2) nationalisation or (3) pursuant to a government directive to reorganise, restructure, merger or takeover.

In the MOF Guidelines issued in January 2008, it has been stated that the unabsorbed losses and capital allowances can be carried forward regardless of the shareholding change that occur, provided that the company in question is not a “Dormant” company.

Proposal

The Institute commends the Government on its decision to amend its policy on the carry forward of losses and unabsorbed capital allowances as reflected in the MOF Guidelines issued in January 2008 and it is envisaged that this measure will have a positive impact.

The legislation will need to be amended to reflect this change and the practical issues on revising the income tax returns for the affected years of assessment for taxpayers need to looked into.

3. Real Estate Investment Trusts (REIT)

3.1 Mismatch of Income

Section 61A of the Act provides that the total income of a unit trust (i.e. a unit trust approved by the Securities Commission as a Real Estate Investment Trust or Property Trust Fund) for a year of assessment which is equivalent to the amount of income distributed to the unitholders in the basis period for that year of assessment which is ascertained by reference to the unitholders’ share of income shall be exempt from tax.

It is to be noted that "income distributed" is a cash flow concept whilst "total income" is a tax concept and there is a mismatch between the two concepts. It is not possible to determine the income that can be distributed without knowing the amount of tax. Likewise, it is not possible to determine the amount of tax without knowing the income distributable, as shown in the following example:

Income Statement

	RM
Rent	10
Dividends	4
Interest	6

	20
Less: Depreciation	(4)
Other expenses	(6)
(all allowable)	--------
Net income	10
Less: Tax payable *	X

Net income after tax	Y
(distributable income)	=====

Tax Computation

	RM
Net income	10
Add: Depreciation	4

	14
Less: Capital allowance	(2)

Chargeable income	12
Less: Income distributed	Y
(exempt from tax)	-------
Chargeable income	Z
subject to tax	====

** From YA 2007, where 90% or more of the total income is distributed, the total income shall be exempt from tax.*

The above shows that the tax amount (X) is dependent on amount of income distributed (Y) to arrive at the chargeable income (Z), whilst Y is dependent on X.

3.2 Withholding Tax Rate

Unitholders may receive distributions from the REIT out of income which is exempt from tax under Section 61A. The unitholders will be taxed on the gross dividend income received. The tax rates, as legislated following the 2007 Budget, applicable to the unitholders on dividends received from the REIT are as follows:

- Individual resident unit holders -	15%
- Individual non-resident unit holders -	15%
- Corporate resident unit holders - *(other than a company with paid-up capital in respect of ordinary shares of not more than RM2.5m at the beginning of the basis period for a year of assessment)*	27%
- Corporate non-resident unit holders -	27%
- Foreign institutional investors -	20%

In Singapore, both resident and non-resident individual unitholders are exempt from tax on dividends received. Dividends received by non-resident institutional investors are subject to withholding tax of 10%.

Proposal

To further promote the REIT industry and to attract foreign investors, the following measures are proposed -

(a) resident and non-resident individual unitholders be exempt from tax on dividends received from the REIT for a specific period of time.

(b) non-resident institutional investors be subject to a reduced withholding tax of 10% instead of 20%. The withholding tax rate should be at par with the other payments subject to withholding tax such as royalties and technical fees.

(c) regulators need to work together to expedite the process in relation to the setting up of and the operation of REITs. The SC has indicated that the approval process should take 2 months provided all documentation is in order. However, this does not take into account the State Authority approval that may be required. Under the

National Land Code, it appears that State Authority approval is required where land is transferred to a trust and any one of the beneficiaries is a non-citizen or a foreign company. State approval can certainly take a long time.

4. Reinvestment Allowance (RA)

Over the years, the Government has offered a wide range of incentives to the manufacturing sector, with greater emphasis on specific industries such as the high technology industry and food production industry. Specific incentives are also offered to promote activities or products and to companies located in promoted areas to trigger growth in these activities/areas.

To encourage expansion of production capacity, modernisation and diversification in the manufacturing sector, the RA incentive has been constantly improved to ensure that it remains attractive to investors. The 2002 Budget extended the RA period from 5 years to 15 years whilst the 2003 Budget allowed a company enjoying pioneer status, which intends to undertake reinvestment before the expiry of its pioneer status to claim RA on condition that the pioneer status is surrendered for cancellation.

Currently, RA is granted to manufacturing companies and producers of promoted food products on capital expenditure incurred on a factory, plant or machinery used in Malaysia for the purposes of any qualifying project, i.e. a project undertaken by the company for the expansion, modernisation, automation or diversification of its existing business. Such expenditure does not include capital expenditure incurred on plant or machinery which is provided wholly or partly for the use of a director or an individual who is a member of the management, administrative or clerical staff.

The IRB has taken a very restrictive view in interpreting the terms '*manufacturing*' and '*factory buildings*'. Storage areas for raw material and finished goods are not eligible for RA claim. Even within the factory building, the current practice of the IRB is to restrict the RA claim to the floor space of the factory building that relates to the production area and not the entire factory. A factory building would typically include areas for staff amenities and facilities such as lavatories, canteen surau, etc and areas for carrying out quality control checks, packaging and storage of raw materials and finished goods.

If a company expands its operations by constructing a bigger factory and then moving to the new location, the current practice of the IRB is to allow the RA claim on the difference in floor space between the old factory and the new factory.

In a recent Technical Dialogue, the IRB indicated that if a company invests a huge sum of money in capital expenditure to expand its production capacity of the factory, the actual production output should also increase accordingly. If the actual output does not increase, the company would have to prove that it is not merely replacing old assets but the situation is caused by unforeseeable market conditions. It must be appreciated that businesses do make bad decisions but they do not waste their resources when investing funds in expanding capacity. An expansion is an expansion and seeking proof that it is an "expansion" is a waste of resources.

Proposal

In this regard, the Institute would like to propose the following issues for the Government's consideration:

(a) To avoid any ambiguity in the Act, clear definitions and interpretation should be established. For example, capital expenditure incurred on a factory, plant and machinery used for the purpose of a qualifying project is not defined in Schedule 7A (Reinvestment Allowance) to the Act. This has given rise to ambiguity as to what constitutes capital expenditure for a qualifying project. Hence, the definition in Schedule 3 (Capital Allowances and Charges) for capital expenditure incurred for the provision of machinery or plant used for the purposes of a business should be adopted in the context of interpreting provisions relating to RA.

It is suggested that the capital expenditure should include peripheral activities which are part and parcel of the manufacturing activity e.g. installation of plant & machinery to process waste disposal which are regulatory requirements and a warehouse next to a factory which stores raw material and finished products.

(b) With an increase in production, storage space would also have to be increased. A factory increasing its production capacity will definitely have to increase its storage capacity to cope with the increasing raw materials (input) and finished goods (output). Therefore, additional warehouses will have to be constructed or acquired to cope with the additional storage capacity. As the construction or acquisition of these facilities is a direct consequence of a company's expansion phase, RA should be extended to include the cost of these warehouses as part of the expansion cost.

(c) There is also ambiguity about the interpretation adopted by the IRB in disallowing a company to claim RA incurred on an expansion project say in October 2005 after the incentive [Pioneer Status (PS) or Investment Tax Allowance (ITA)] had expired on say 30 June 2005. A pioneer company is excluded from claiming RA for the period in which the company has been granted a pioneer certificate in respect of any promoted activity/product. As the word 'period' is not defined under the Act, it would be reasonable to interpret it as being the tax relief period. As such, capital expenditure incurred for purposes of a qualifying project (as defined in Paragraph 8, Schedule 7A) after the expiry of the tax relief period (during the basis period) should be eligible for RA.

(d) The claim for RA and PS or ITA should be based on products rather than on the company as a whole. For example, a company which enjoys PS in relation to product A should be allowed to claim RA in relation to product B where the RA criteria are met. Further, steps should be taken to widen the scope of RA for the agriculture sector.

(e) Certain business operations are situated in remote areas such as plantations in Sabah, where accommodation needs to be provided to employees as there is no public transportation available for going to work. The construction of housing units for employees is part and parcel of an expansion programme. In addition, buildings used for providing accommodation to management staff do not qualify for capital allowance. This is a disadvantage to the company as there is no other avenue for claiming this business related cost. To encourage reinvestment, the Government should extend the qualifying expenditure to include accommodation provided to staff as the expenditure is part and parcel of an expansion or diversification programme.

(f) To stay competitive, a business must undertake, on an on-going basis, investment in new plant, machinery and technology that enhance automation of its production process and increase productivity. Such capital expenditure should continue to qualify for RA. The time limit for the RA incentive should be removed so as to encourage companies to undertake regular investment in modernisation and automation activities to increase productivity and hence competitiveness.

5. Investment Holding Company

Following the 2007 Budget, an investment holding company (IHC) under Section 60F of the Act is defined as a company whose activities consist mainly in the holding of investments and not less than 80% of its gross income other than gross income from a source consisting of a business of holding of an investment (whether exempt or not) is derived therefrom. Section 60F(1A) of the Act further provides that income of an IHC which is from the holding of investments shall not be treated as income from a source consisting of a business; and income other than income from the holding of investment shall be treated as gains or profits under paragraph 4(f) of the Act.

As provided under Section 60FA(2), for an IHC which is a company resident and listed on the Bursa Malaysia in the basis period for that year of assessment, income of that IHC from the holding of investments in that basis period shall be treated as gross income of that IHC from a source or sources consisting of a business for that year of assessment. However, unabsorbed tax losses and unutilised capital allowances are not allowed to be carried forward to the future years.

Based on the new definition as stated above, rental income received will be treated as investment income if a company solely owns and manages its buildings or complexes even though it provides ancillary or support services/facilities such as security guard service, escalators and lifts, cleaning or housekeeping, etc which actually means that the company is carrying on a business. Under the new provision in the Act, the said company would not be able to carry forward its tax losses and unutilised capital allowances.

Pursuant to Section 60F, permitted expenses refer to expenses incurred by an investment holding company in respect of secretarial, audit and accounting fees, telephone charges, printing and stationery costs and postage, etc.

Proposal

In this regard, the Institute propose the following:-

(a) the tax treatment for an IHC should be based on the fundamental fact of determining whether the source of income is a business or non-business source. If a company owns and manages buildings and provides ancillary or support services/facilities, it should be treated as a business source and the tax losses and unutilised capital allowances should be allowed to be carried forward. Section 60F should only be applied to companies which derive passive income from its investments.

(b) Section 60F should be amended to include tax fees and other similar compliance expenses, EPF and SOCSO contributions as well as bank charges as part of the permitted expenses as these expenses are incurred in the business of holding investments.

(c) The Institute is of the view that listed and non-listed IHCs should not be discriminated and treated differently. The above inconsistency in tax treatment is not fair to taxpayers and creates tax compliance and administrative issues.

6. Tax Incentive on the Cost of Acquisition of Foreign Owned Companies

Under the Income Tax (Deduction for Cost on Acquisition of a Foreign Owned Company) Rules 2003, a locally owned company with at least 60% Malaysian equity ownership is eligible for a deduction in arriving at its adjusted income from a business equivalent to 20%

of the cost of acquisition of a foreign owned company in the year of assessment in which the cost is incurred and the following four years of assessment.

"Acquisition of foreign owned company" means acquisition of a foreign owned company located outside Malaysia for the purpose of acquiring high technology for production within the country or for acquiring new export markets for local products as approved by the Malaysian Industrial Development Authority (MIDA). In this respect, MIDA has issued "Guidelines and Procedures for Application of Tax Incentive to Acquire a Foreign Owned Company" which stipulate that only locally owned companies engaged in manufacturing, trading or marketing activities are eligible for the incentive.

Proposal

The 2003 Rules do not prescribe that the incentive is confined to locally owned companies engaged in manufacturing, trading or marketing activities but yet MIDA's guidelines prescribe that the incentive applies only to locally owned companies engaged in these activities. The incentive should be extended to companies in the services sector, such as banking, finance, insurance, telecommunications, professional services, stock broking, etc and this is demonstrated by the services sector being the engine of growth in recent years. This will promote Malaysia as the centre of excellence in providing these services to the ASEAN region and Asia as a whole.

7. Healthcare Sector

Significant expenses are incurred by investors in the healthcare industry to enhance the skills and expertise of the medical personnel, obtaining accreditation status, investing in new and specialised equipment in order to improve the general healthcare services and to venture into high end and niche services. In addition, the key healthcare industry players also have invested substantially in health tourism, which is a fast growing segment in the tourism industry in Malaysia.

Proposal

To further enhance the growth of health tourism and upgrade the quality of health services, the Institute proposes that the following be considered:

(a) Double deduction on expenses incurred for improving skills and expertise of the medical profession (overseas and local training, etc);

(b) Double deduction on expenses incurred by hospitals to obtain accreditation status such as hospital accreditation, laboratory accreditation, etc. and other clinical accreditation status to ensure high standards of care delivery that are comparable with international organisations;

(c) Double deduction for expenses incurred for the promotion of wellness programmes as this will assist the Government in promoting a healthy society and quality of life. These may include promotional expenses for example, marketing expense, discounts given, health campaign ,etc. Wellness program include Annual Medical Check Up, Executive Screening Program, Health Screening, Patient & Public Education Seminar/ Conference, Health Talk, etc.

(d) Double deduction for repair and maintenance expenditure of high-technology machines used in the treatment of critical illnesses such as breast cancer etc.

(e) Double deduction for training and retraining of staff in operating newly acquired high technology machines.

(f) Tax incentives for the usage of specialised equipment used for clinical diagnostic purposes and hence create a competitive edge for the health tourism business in Malaysia. Accelerated capital allowances could be granted on such equipment e.g. accelerated capital allowance on capital expenditure incurred on the system used in cancer treatment such as tomotherapy which is a new revolutionary radiation therapy delivery system with cutting edge technology.

(g) Reinvestment allowance is proposed for high end and niche services e.g. bone marrow studies and transplant, liver transplantation services, etc.

8. Research and Development Sector

8.1 Research & Development Company

Currently, a research and development (R & D) company carrying out research and development projects for its related companies enjoy Investment Tax Allowance (ITA) of 100% of qualifying capital expenditure incurred within a period of 10 years. The allowance is abated against 70% of the statutory income for each year of assessment.

Under Section 34B (2) of the Act, where the R & D company has been granted and is claiming ITA under the PIA, its related companies are not allowed to claim double deduction for the qualifying revenue expenditure they incurred on the use of its R&D services. The related companies may only claim double deduction for the qualifying revenue expenditure if the R & D company opts not to claim ITA.

Proposal

It is proposed that the ITA be allowed against 100% of statutory income of the R & D company to promote R&D and encourage the utilisation of a research company's services to improve the quality of products and services.

8.2 In-House R & D Activities

Currently, a company carrying out in-house R & D activities is given an ITA of 50% on qualifying capital expenditure for a period of 10 years. The allowance is abated against 70% of the statutory income for each year of assessment.

Proposal

It is proposed that the ITA be increased to 100% and to be allowed against 100% of statutory income of the company. Whether a particular research and development is carried out in-house or by external research institutes, the objective remains the same. Therefore, the incentive given under both circumstances should be equal. There are also compelling reasons for companies to conduct research in-house, for example the confidentiality of trade secrets or patented technology processes. The above proposal will further encourage companies to conduct in-house R & D activities.

9. Property Sector

Pursuant to Clause 10 of the Income Tax (Property Development) Regulations 2007 ("the Regulations"), a project or phase is deemed completed upon either the date on which the Temporary Certificate of Fitness for Occupation ("TCFO") or the date on which the Certificate of Fitness for Occupation ("CFO") is issued. The property developer must then determine the actual profit for the project and prepare a final account up to that date for the entire project.

The Institute is of the view that the true date of completion of a project is the end of the defects liability/warranty period. The timing of the final account preparation (upon issuance of TCFO or CFO) as stipulated in the Regulations does not take into consideration large developments i.e. township developments and costs incurred after the issuance of TCFO or CFO.

For property development companies which have undertaken township development, the finalisation of accounts would hinge on a number of factors e.g. changes in regulatory/government specifications needed for infrastructure facilities like road widths and drain sizes, cost variations in the components of infrastructure costs and land related costs. Therefore, the actual profit for the project is normally determined upon finalisation of billings issued by contractors and/or subcontractors, a few months/years after handing over of the vacant possession of a property unit to a buyer.

Further, there are costs which are normally incurred after the CFO date and there may also be variation orders which were not taken up at the date of completion. In practice, costs that would not be taken up as at the CFO date vary from 10%~25%. In this regard, the actual profit of the project or phase is generally overstated at the date of TCFO or CFO.

Proposal
It is proposed that for property developers, the date of completion be based on the final accounts i.e. 18 months from the date of handover which is in line with the Housing Development Act requirements on Defect Liability Period. Alternatively, a possible /reasonable period could be 12 months after the issuance of the CFO or TCFO.

10. E-Commerce

Currently, there are no specific provisions in the Act that deals with e-commerce. With rapid globalisation in the business world, the use of e-commerce is inevitable. Taxpayers need to understand the tax treatment resulting from e-commerce transactions – the basis of taxation, double tax implications as well as the withholding tax implications on payments for internet services, electronic transactions, software payments, etc.

In Singapore, the IRAS has issued a circular dated 28 February 2003 to provide clarification on payments for digitised goods and the use of or right to use information. Included in the exemption from taxation are payments for digitised goods (eg. music videos, logos) and the use of information (eg. Information obtained from Bloomberg, Forrester and Lexis-Nexis). A circular was also issued by the IRAS on 23 February 2001 to assist taxpayers to understand the tax treatment for e-commerce transactions.

Prior to that, the IRAS issued a circular on 29 December 2000 (reissued on 23 February 2001) to exempt withholding tax on four categories of software payments, namely, shrink-wrap software, downloadable software for end-users, site licence and software bundled with computer hardware.

Proposal
In view of the uncertainty surrounding the tax treatment of various activities relating to e-commerce, it is proposed that specific provisions/guidelines be introduced to provide clarity. This would provide taxpayers with more certainty and assist the Government to achieve its objective to promote electronic commerce and the use of information communication technology in business operations.

11. Franchising

The development of SMEs has been identified as an important component of future economic growth. One of the methods of developing entrepreneurship is to encourage franchising. However, apart from the availability of soft loans for SMEs, there is no other tax benefit or tax break for franchisees to lower their overall cost of investment.

Besides capital investment in fixed assets, a franchise also requires an upfront payment of franchise fees as well as training fees. In addition, there are royalty fees on sales and also rental and security deposits. The total initial investment for a franchisee is quite substantial.

Proposal
In order to promote franchising activities and reduce the cost of investment to the franchisee, it is proposed that for the purposes of ascertaining the adjusted income of a franchisee, the lump sum payment of the franchise fee by the franchisee be tax deductible over a 5 year period (i.e. an amount equal to one-fifth of the total initial cost of investment by the franchisee for that year of assessment and for each of the four following years of assessment be tax deductible), in line with the deduction for cost of acquisition of proprietary rights which is available to the manufacturing sector.

12. Incentives for Securitisation and Issuance of Securities

The costs of issuing asset-backed securities and private debt securities under Islamic principles incurred by a company were specifically allowed as a deduction against business income by various income tax orders, which expired in the year of assessment 2007. [*Income Tax (Deduction for Expenditure on Issuance of Asset-Backed Securities) Rules 2005; Income Tax (Deduction for Expenditure on Issuance of Islamic Private Debt Securities Pursuant to Istisna' Principles) Rules 2003* and *Income Tax (Deduction for Expenditure on Issuance of Islamic Private Debt Securities under Islamic Principles) Rules 2003*.] The *Income Tax (Deduction on the Cost of Issuance of the Islamic Securities) Rules 2007* allows deduction of cost of issuing Islamic securities incurred by special purpose company with effect from year of assessment 2007.

In addition, certain expenses incurred by a special purpose vehicle prior to the issuance of debt securities are not allowed against its income. Similarly the initial rating fees incurred by the special purpose vehicle needs to be also considered a deductible expense in the interest of maintaining tax neutrality and encouraging securitisation and enhancing the capital market.

Proposal
The Institute proposes that a specific order be issued to allow the deduction of the costs mentioned above as well as appropriate guidelines be issued for asset-backed securitisation to incorporate such expenses.

13. Foreign Associations

Currently, internationally affiliated organization for the promotion of trade, culture, humanity, education, professions registered in Malaysia are subject to tax on their profits derived from Malaysia. Some of these organisations are not profit-motivated and are essentially set up to maintain international affiliation. Some may even receive foreign government subsidy to carry out charitable objectives. Generally, these associations can register as companies limited by guarantees. However, this can be administratively cumbersome.

Proposal
The Government should consider providing favourable treatment for foreign organisations which may decide to set up their office or secretariat in Malaysia. The necessary law should be amended/improved so as to allow easier registration of associations with large number of members who are based overseas. This would encourage more activities such as printing, seminars and conferences, etc being held in Malaysia. These international conferences could then translate into economic benefits to the country and promote tourism as well, etc.

E. DEVELOPMENT OF HUMAN CAPITAL

1. Deduction for Continuing Professional Education (CPE) courses

In order to sustain the quality and continuous improvement of the professionals' knowledge, skills, competence and professional values in providing services to clients, employers, regulators and other stakeholders, members of professional bodies are required to complete a stipulated number of CPE hours within a specific time frame.

Proposal
In view of the fact that such expenses are incurred in the production of employment income, it is proposed that the cost incurred by an individual in attending CPE courses in order to fulfil the CPE requirements of the professional bodies be deductible against the employment income, in the same manner as professional subscription fees.

2 Incentive for Unemployed Graduates Training Scheme

The Income Tax (Deduction for Allowances under the Capital Market Unemployed Graduates Training Scheme) Rules 2006, allowances given by listed companies to participants in the Unemployed Graduates Training Scheme during the period from 1 October 2005 to 31 December 2008 will be given a double deduction. This scheme needs to be endorsed by the Securities Commission.

Proposal
The Institute would like to suggest that the scope be widened to allow non-listed companies, including the professional firms which also participate in such scheme to obtain the double deduction. This would provide the graduates with wider opportunities to be trained and therefore, improving their skills and knowledge.

3 Double Deduction for Approved Training

It is noted that a company will be given double deduction on training if it is conducted by approved training institutions. However, only a small number of training institutions have been granted such status and the courses offered are limited in scope. Manufacturing companies with less than 50 employees which undertake in-house training or send their employees for training in an institution other than the approved training institutions will have to apply for approval before the training expenses are given double deduction. Furthermore, only training courses for certain manufacturing skills are identified for the incentive.

The Government has been giving greater emphasis to human resource development in the manufacturing sector. In line with the Government's strategy to develop the services industries into a key economic sector, the range of approved courses and training programmes and the scope of eligibility for the incentives must be widened. More incentives should be provided to encourage all industries to invest in their human capital, particularly the service industries. The services sector accounts for a substantial portion of the country's GDP.

Proposal

The Institute suggests that the double deduction incentive be extended to training programmes undertaken by firms involved in professional services such as accountancy, taxation, secretarial, engineering, architecture, law, medicine, etc. Accounting and tax firms have been actively involved in the training of new graduates to become qualified professional accountants and tax agents as well as in continuing professional development of their qualified staff. Tax agents have been sending their staff to attend to various tax courses organised by IRB, IROU, MIT and other professional bodies to keep their staff updated on developments under the self-assessment system.

It is also proposed that the double deduction incentive be extended in respect of expenses incurred in approved training to a wider range of training courses and a larger number of training organisations including:

- Education and training programmes conducted by professional bodies which lead to the attainment of a professional qualification.
- Continuing professional development programmes organised by professional bodies.

4. Tax Residence Status of Individuals

One of the conditions for an individual to qualify for residence status for purposes of income tax is that the individual is required to be in Malaysia for at least 182 days in a basis year.

Proposal

It is proposed that the distinction between residents and non-residents be removed. The same income tax rules and rates should apply to all. The abolition of such distinction between residents and non-residents, citizens or permanent residents, would not only simplify the tax administration, but would also assist in attracting foreigners to invest in Malaysia.

F. PROMOTING A CARING SOCIETY

1. Personal Income Tax Reliefs/Exemptions

1.1 Personal relief on day-care facilities for children

Based on the 2000 Population Census, about 48% of the female population in the country was in the working age group of 15 to 64 years. However, the number of women currently involved in the country's work force only accounts for one-third of the total work force.

The Institutes wish to commend the Government for taking various measures and efforts to mobilise this available pool of resources, and therefore increasing the supply of labour and contributing towards enhancing the nation's output.

Proposal

In this respect, the Institute proposes that a relief of up to RM2,000 be allowed to working parents for the use of day-care facilities or kindergartens or engage an assistant for their children. The above relief will encourage qualified or skilled individuals to engage professional people to attend to their children, and this will enable the "home-parents" (especially women) to return to the workforce and consequently increase the per capita income of the family.

1.2 Personal relief for insurance premiums and contributions to approved schemes

The Government, in encouraging the growth of the life insurance industry, has increased the maximum aggregate amount of relief in respect of life insurance premiums and contributions to approved schemes to RM6,000 with effect from the year of assessment 2005.

Proposal

In view of the rising costs, the Institute proposes that the current maximum aggregate relief of RM6,000 for life insurance premiums and contributions to approved schemes be amended as follows to reflect the current economic situation:

Category	Maximum Aggregate Relief (RM)
Life Insurance Premiums	6,000
Contributions to Approved Schemes	6,000

Apart from encouraging saving by individual taxpayers, the creation of separate categories for the above-mentioned personal relief would further sustain and encourage the growth of the life insurance industry. More approved pension and provident funds should be created to encourage employees to save for their old age.

1.3 Tax Relief for Interest on Housing Loans

Tax relief for three years of assessment until year of assessment 2005 was granted on interest payments to new buyers of completed houses and first-time owners of houses costing between RM100,000 to RM180,000. This provision applied to houses purchased from 1 June 2003 to 31 May 2004.

Proposal

To further stimulate the property sector and ownership of houses, the above relief should be reintroduced with an increased threshold to reflect the current market situation, or alternatively with a maximum relief capped at a certain threshold. This will assist the average income earners to own houses and also assist in stimulating the property sector.

2. Cost of Living Allowance

With the increase cost of utilities, there is increasing concern among consumers that they would have to spend a lot more on household expenses. The effects of the fuel price increase on consumer goods are inevitable. The increase in the price of petroleum products will burden every worker in the country.

Proposal

(a) To lessen the financial burden of individuals following the increase in fuel price, the Institute proposes that the cost of living allowance, transport and travelling allowance, food allowance, etc. be exempted in the hand of employees.

(b) To encourage private sector employers to provide such an allowance to their employees, it is proposed that a double deduction be given to companies which pay cost of living allowances to their employees.

3. Corporate Social Responsibility

The scope of approved community projects under Section 34(6)(h) of the Act should be extended to allow tax deductions incurred by taxpayers on expenses relating to corporate social responsibility ("CSR"), e.g. environmental friendly projects such as preservation and conversation of forest, animals and sea species.

With the encouragement from the Malaysian Government for corporate citizens to contribute to CSR projects in order to improve the well-being of the community at large, substantial amounts have been incurred annually by the private sector on community projects. The CSR projects undertaken by the private sector are not confined to only education, health, housing, infrastructure and information and communication technology but have been extended to environmental aspects such as setting up a seed bank to preserve the forest species, conservation of coral reefs and others.

The amount spent on environmental CSR projects are not tax deductible as it does not fall within the ambit of approved community projects under Section 34(6)(h) of the Act as this covers only expenses incurred on the provision of services, public amenities and contributions to a charity or community project pertaining to education, health, housing, infrastructure, and information and communication technology.

Proposal

It is proposed that the scope of approved community projects be extended to include environmental CSR in order to encourage the private sector to be involved in environmental friendly projects to preserve the natural environment in Malaysia.

CONCLUSION

The Institute wishes to thank the Ministry for granting us the opportunity to present our views and proposals to the 2009 Budget. We will be pleased to meet with the Ministry to discuss/elaborate on these proposals.