Professional Level – Options Module

Advanced Taxation (Malaysia)

Friday 5 June 2015

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

This paper is divided into two sections:

Section A – BOTH questions are compulsory and MUST be attempted

Section B – TWO questions ONLY to be attempted

Tax rates and allowances are on pages 2–4

Do NOT open this paper until instructed by the supervisor.
During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.
This question paper must not be removed from the examination hall.

The Association of Chartered Certified Accountants

Paper P6 (MYS)

ACCA

SUPPLEMENTARY INSTRUCTIONS

1. You should assume that the tax rates and allowances shown below will continue to apply for the foreseeable future.
2. Calculations and workings should be made to the nearest RM.
3. All apportionments should be made to the nearest whole month.
4. All workings should be shown.

TAX RATES AND ALLOWANCES

The following tax rates, allowances and values are to be used in answering the questions.

Income tax rates

Resident individual

Chargeable income

Band RM	Cumulative RM	Tax payable Rate %	Tax payable Cumulative RM
5,000	5,000	0	0
15,000	20,000	2	300
15,000	35,000	6	1,200
15,000	50,000	11	2,850
20,000	70,000	19	6,650
30,000	100,000	24	13,850
Excess		26	

Non-resident individual

All chargeable income	26%

Resident company

Paid up ordinary share capital	RM2,500,000 or less	More than RM2,500,000
On the first RM500,000	20%	25%
On the remainder	25%	25%

Non-resident company

All chargeable income	25%

Labuan entity – income from a Labuan trading activity

All chargeable profits	3%

Trust body – resident or non-resident

All chargeable income	25%

Personal deductions

		RM
Self		9,000
Self – additional if disabled		6,000
Spouse		3,000
Spouse – additional if disabled		3,500
Child – basic rate	each	1,000
Child – higher rate	each	6,000
Disabled child	each	5,000
Disabled child – additional	each	6,000
Life insurance premiums, approved scheme contributions	maximum	6,000
Deferred annuity premiums, private retirement scheme contributions	maximum	3,000
Medical expenses for parents	maximum	5,000
Medical expenses for serious disease of self, spouse or child, including up to RM500 for medical examination	maximum	5,000
Basic supporting equipment for self, spouse, child or parent if disabled	maximum	5,000
Educational and medical insurance for self, spouse or child	maximum	3,000
Study course fees for skills or qualifications	maximum	5,000
Purchase of a personal computer	maximum	3,000
Purchase of books, magazines etc for personal use	maximum	1,000
Purchase of sports equipment	maximum	300
Deposit for child into the National Education Savings Scheme	maximum	6,000

Rebates

Chargeable income not exceeding RM35,000	RM
Individual – basic rate	400
Individual entitled to a deduction for a spouse or a former wife	800

Capital allowances

	Initial rate %	Annual rate %
Industrial buildings	10	3
Plant and machinery – general	20	14
Motor vehicles and heavy machinery	20	20
Office equipment, furniture and fittings	20	10
Agriculture allowance		
Buildings for the welfare of employees	nil	20
Other buildings used in the business	nil	10
All other qualifying agricultural expenditure	nil	50

Real property gains tax

	Individuals (citizens and permanent residents) Rate %	Individuals (non-citizens) Rate %	All other persons Rate %
Date of disposal			
Disposal within three years after the date of acquisition	30	30	30
Disposal in the fourth year after the date of acquisition	20	30	20
Disposal in the fifth year after the date of acquisition	15	30	15
Disposal in the sixth year after the date of acquisition or thereafter	0	5	5

Sales and service tax

	Rate %
Sales tax	10
Service tax	6

Stamp duty

Rates of duty under the First Schedule
Conveyance, assignment, transfer or absolute bill of sale

	Rate %
For every RM100 or fractional part thereof:	
On the first RM100,000	1
On the next RM400,000	2
On the excess over RM500,000	3

Section A – BOTH questions are compulsory and MUST be attempted

1 Yesterday, you and your tax principal participated in a conference call with the senior management of Planet Sdn Bhd (Planet), an investment holding company. Below are extracts from the notes of the conference call and an email from your tax principal to you, his tax assistant.

Extracts from the notes of the conference call

Planet has identified Sun Sdn Bhd (Sun), a Malaysian resident, as a suitable investment.

Planet and Sun are currently unrelated.

Sun has been manufacturing solar panels for three years and has an accumulated tax loss of RM6·8 million and unabsorbed capital allowances (CA) of RM1·5 million as at the year ended 31 May 2015.

Apart from the solar panel manufacturing business, Sun does not have any other assets or sources of income.

Sun expects to make an accounting profit of about RM8·5 million in the year ended 31 May 2016. The negotiated price for Planet either to purchase Sun's shares or take over Sun's manufacturing business (purchase of assets and liabilities) is RM75 million.

Whichever alternative is chosen, Planet will finance the acquisition with a loan of RM55 million from its non-resident parent company and RM20 million from a Malaysian commercial bank. The annual interest rates on these loans will be 11·5% and 7% respectively.

Planet would like to know what difference there would be from an income tax perspective if it acquired the entire share capital of Sun as compared to acquiring all the business assets and liabilities of Sun's manufacturing business.

Extracts from the email from your tax principal

Please draft a letter to the managing director of Planet regarding the proposed investment in Sun.

Consider the two options for the proposed acquisition:

Option 1: Planet will acquire 100% of the share capital of Sun for RM75 million; or

Option 2: Planet will acquire all the assets and liabilities of the manufacturing business of Sun for RM75 million.

The issues you should consider for each option are:

(i) the form of income derived from the investment in Sun by Planet;

(ii) the deductibility of the interest expense for Planet;

(iii) any transfer pricing issue/s;

(iv) the treatment of the trade receivables and inventory; and

(v) Sun's unabsorbed loss and CA brought forward.

(vi) Comparative tax computations

To demonstrate the differences in the income tax treatment under the two options, I suggest that you supplement your explanations to the client with comparative tax computations of the chargeable income of the Sun business **after** taking into account the interest expense for the Sun manufacturing business for the year of assessment (YA) 2016.

For this purpose, you should assume that the tax adjusted income for the business under both options for YA 2016 will be RM9·8 million **before** taking into account the interest expense; and the current year CA is RM300,000 if the business remains within Sun (Option 1), and RM540,000 if the business is owned by Planet (Option 2).

(vii) Tax planning advice/ideas

Lastly, assuming that Option 2 is adopted, identify any possible tax planning advice/ideas with regard to the interest rate on the loan from Planet's non-resident parent company and the trade receivables and the inventory to be taken over.

Required:

Draft the letter to the managing director of Planet Sdn Bhd as requested by the tax principal. The following marks are available:

(i) Form of income derived by Planet from the investment. (2 marks)

(ii) Deductibility of the interest expense. (4 marks)

(iii) Transfer pricing issues. (4 marks)

(iv) Trade receivables and inventory. (7 marks)

(v) Unabsorbed loss and capital allowances brought forward. (6 marks)

(vi) Comparative computations of chargeable income. (5 marks)

(vii) Tax planning advice/ideas. (3 marks)

Professional marks will be awarded in question 1 for the appropriateness of the format and presentation of the letter and the effectiveness with which the information is communicated. (4 marks)

(35 marks)

2 Two months ago, the Inland Revenue Board (IRB) conducted a tax audit on your client, Inovasi Sdn Bhd (Inovasi), a producer of home appliances. Subsequently, the IRB raised an additional tax assessment on Inovasi dated 5 May 2015 which included a 45% penalty for an incorrect tax return. The IRB also issued a letter dated 5 May 2015 listing the tax adjustments made. Both the notice of assessment and the letter were delayed in the post and only received by Inovasi on 30 May 2015.

Extracts from an email from your manager outlining the IRB's adjustments and from the client's file records are set out below.

Extracts from the email from your manager

I am preparing for a meeting with Inovasi tomorrow regarding the additional assessment of tax raised.

As you are aware, the IRB raised an additional tax assessment relating to certain tax adjustments made in respect of items in Inovasi's statement of profit or loss for the year ended 31 March 2014. I have listed below the items which the IRB have disallowed:

(i) 50% of RM78,000 being catering services

The IRB have argued that, as an entertainment expense item, 50% is disallowable.

(ii) Commission of RM100,000 paid to a non-resident

The IRB have argued that, as the withholding tax provisions have not been complied with, this commission is disallowable.

(iii) Repair and maintenance of machinery of RM180,000 relating to an engine overhaul

The IRB have argued that the substantial amount of this expense indicates that this is capital in nature and thus disallowable; and

(iv) Product improvement of RM1,250,000

The IRB have argued that this expense is capital in nature and thus disallowable.

In advance of my meeting, I would like you to brief me on the following:

(a) Deductibility of the expense items

The grounds, with detailed reasoning, in defence against the disallowance of each of the above four expense items and your conclusion on the deductibility of each item;

(b) Penalty for incorrect return

Your advice on whether or not the 45% penalty included in the tax assessment for YA 2014 is appropriate in light of your conclusions on the deductibility of the expense items in (a); and

(c) Valid appeal

Whether or not the additional assessment can still be appealed against by Inovasi and the procedure which must be followed for such an appeal to be valid.

Extracts from Inovasi's file records

(i)	The RM78,000 catering services cost represents the catering (food and beverage) expense for the product launch of the latest range of home appliances.
(ii)	The commission was paid to Mr Carlos Santiago of Brazil for introducing customers to Inovasi. Mr Santiago operates a well-known business of sales introductory services in Brazil. He charges a commission for introducing customers to businesses.
(iii)	The machinery was acquired at a cost of RM5 million two years ago. The overhaul, involving replacement of parts, is recommended once every 24 months to keep the machinery in proper working order.
(iv)	The RM1,250,000 comprises the cost of testing additional improved features to existing product models in order to maintain the performance of these appliances.

Required:

Carry out the work as instructed by your manager.

The following marks are available:

(a) Deductibility of the expense items:

- **(i) Catering services expense;** (5 marks)
- **(ii) Commission;** (5 marks)
- **(iii) Repair and maintenance;** (5 marks)
- **(iv) Product improvement.** (4 marks)

(b) Penalty for incorrect return. (3 marks)

(c) Valid appeal. (3 marks)

(25 marks)

Section B – TWO questions ONLY to be attempted

3 On 1 June 2015, Best Sdn Bhd (Best), a trading company which makes up its accounts annually to 30 June, was taken over by Excellent Bhd (Excellent). Excellent makes up its accounts annually to 30 September.

In 2015, Best intends to change its year end to be coterminous with its new holding company, Excellent. It will apply to the Director General of Inland Revenue (DGIR) to direct its basis period/s. Best's accounting periods are as follows:

1 July 2013 to 30 June 2014
1 July 2014 to 30 September 2015
Thereafter annually to 30 September

Best operates solely from Kuala Lumpur, although it imports and exports from neighbouring countries. To expand its business, Best has recruited Miss Rajin (Rajin) to be based in China for 24 months from 1 July 2015 to 30 June 2017. Rajin has never left Malaysia for any extended period prior to 1 July 2015.

While in China, Rajin will actively seek out suppliers and customers for Best's trading business. Rajin will travel extensively within China. She is fully authorised to enter into business contracts on Best's behalf. Best intends to charge all expenses relating to Rajin's deployment in China to its business accounts in Malaysia.

Once every three months, Rajin will spend a week in Kuala Lumpur to report her progress to and have discussions with the marketing director of Best.

Throughout the whole of the 24-month period, Rajin will continue to derive rental income from her property in Malaysia. Each year, Rajin will remit 50% of her Chinese income back to Malaysia.

Rajin plans to spend a month touring China at the end of her 24-month deployment, before relocating back to Malaysia in August 2017.

The Malaysia–China double tax agreement is based on the OECD model double tax agreement and provides for relief for double taxation by credit.

Required:

(a) **Explain how Best Sdn Bhd's basis periods for the years of assessment 2015 and 2016 will be determined, whether by direction by the Director General of Inland Revenue or otherwise, demonstrating how the underlying principles are satisfied.** (6 marks)

(b) **Explain, with reasons, whether Best Sdn Bhd is likely to have a permanent establishment in China from 1 July 2015.** (4 marks)

(c) **Assuming Best Sdn Bhd does have a permanent establishment in China from 1 July 2015, explain the income tax implications and treatment for the company for the purposes of Malaysian tax during the 24 months, on the assumption that the profits attributable to the permanent establishment are subject to tax in China.** (4 marks)

(d) **For each of the years of assessment 2015, 2016 and 2017, state, with reasons, Miss Rajin's Malaysian residence status and explain her Malaysian income tax treatment.** (6 marks)

(20 marks)

4 A famous artist fulfilled a childhood pledge to save the world by setting up a trust (the BnB Trust) to help the homeless. He held an art sale of his works in January 2014 and made sales amounting to RM1 million and immediately transferred this sum to the newly-established BnB Trust. The artist then took a year off to relax, and did not derive any other income at all during the year 2014.

The artist's two best friends, who are both accountants, were appointed as trustees of the BnB Trust. The trustees invested the RM1 million from the art sale in a shophouse in the inner city and in dividend-yielding shares and placed the remainder of the sum in fixed-term deposits with Malaysian banks.

The shophouse is used as a service centre for the homeless. The ground floor of the shophouse has been converted into a soup kitchen to prepare and serve simple nutritious meals once a day at noon for a price of RM1 per serving. There is also a clinic which provides medical attention at RM1 per visit. The upper floor features dormitories and shower cubicles. The BnB Trust provides a clean foldable canvas bed for RM2 per night and a hot shower at 50 sen per person.

The two trustees are paid trustees' remuneration of RM6,000 per annum each. The trustees spend 80% of their time supervising the running of the centre and coordinating the many volunteers who come to help with cooking, cleaning, treating and counselling at the centre. Three full-time caretakers are employed to ensure the smooth functioning of the centre.

The BnB Trust is not an approved institution or organisation. Nevertheless it receives a steady stream of donations from well-wishers and supporters.

The BnB Trust's statement of profit or loss for the year ended 30 April 2015 indicates the following:

	RM	RM
Income:		
Sale of meals and services	328,000	
Malaysian dividends	10,000	
Interest from Malaysian banks	3,000	
Donations	120,000	
		461,000
Less: Expenditure		
Cost of meals and services	400,000	
Utilities	36,000	
Trustees' remuneration	12,000	
Salary to caretakers	43,200	
Depreciation	10,000	
		(501,200)
Net loss		(40,200)

Required:

(a) (i) Explain the income tax treatment for the artist for the year of assessment 2014 in respect of the sale of the artworks and transfer of the RM1 million to the BnB Trust. (3 marks)

(ii) Explain how your answer in (i) would change if the RM1 million had been transferred to an approved organisation instead of to the BnB Trust. (2 marks)

(b) In respect of the receipts from the provision of food and services to the homeless, state the arguments for these being treated as each of the following in the hands of the BnB Trust for tax purposes:

- **income from a business of providing food and shelter;**
- **other income [under s.4(f)]; and**
- **non-income receipts.** (6 marks)

(c) State the arguments for and against the donations received by the BnB Trust being treated as 'income'. (3 marks)

(d) Assuming that the receipts from the provision of food and services and the donations both constitute business income, and that there are no capital allowances for the year, compute the chargeable income of the BnB Trust for the year of assessment 2015. Clearly show any losses to be carried forward.

Note: Start your tax computation with the gross income figures. You should label the figures comprising the stages of the computation and indicate, by the use of the word 'nil', any item shown in the statement of profit or loss for which no tax adjustments are necessary. (6 marks)

(20 marks)

5 ABC Sdn Bhd (ABC) was incorporated in Malaysia on 1 February 2012 with an authorised and paid-up share capital of RM2 million held by Miss A (25%), Mr B (30%) and Mr C (45%).

Prior to 8 March 2012, the cash of RM2 million from the paid-up share capital was ABC's only tangible asset. On 8 March 2012, the company acquired a piece of land for RM500,000, in cash. ABC completed the construction of a factory on the land on 31 August 2012, at a cost of RM1 million, and commenced the manufacturing of industrial printers on 1 October 2012. ABC makes up its accounts annually to 30 September.

As business has been profitable, ABC is now ready for expansion. It has commenced construction of a new factory building at a cost of RM3·4 million on the existing land with completion expected no later than 30 June 2015. At the same time, ABC plans to install and commission new machinery costing RM5 million by the end of July 2015 so that production may commence in early August 2015. ABC is also considering the alternative of leasing (rather than buying) this new machinery for a total cost of RM5·5 million, payable over three years.

Miss A is contemplating disposing of her entire 25% shareholding in ABC to a new shareholder, Mr D. Miss A is worried about her exposure to real property gains tax as she fears that ABC may have become a real property company (RPC) at some point in its development.

Required:

(a) (i) State the conditions which must be fulfilled for a company to be eligible for the reinvestment allowance and explain whether ABC Sdn Bhd fulfills each of them in the year of assessment 2015. (7 marks)

(ii) Advise ABC Sdn Bhd on what it needs to do or do differently regarding the new factory building and machinery in order to qualify for the maximum available reinvestment allowance claim. Clearly state the relevant year of assessment and qualifying expenditure based on your advice. (5 marks)

(iii) Assuming ABC Sdn Bhd qualifies for the reinvestment allowance in the year of assessment 2015, explain the potential consequences if it then sells the manufacturing business in the year 2017. (2 marks)

(b) Explain whether ABC Sdn Bhd will or will not have the status of a real property company (RPC) at each of the following dates:

- **1 February 2012;**
- **8 March 2012;**
- **31 August 2012; and**
- **30 June 2015.** (6 marks)

(20 marks)

End of Question Paper

1 Letter to Planet Sdn Bhd

Tax Principal,
Tax Firm,
Any Street,
Any Town,
Malaysia.

The Managing Director,
Planet Sdn Bhd,
Any Street,
Any Town,
Malaysia.

5 June 2015

Dear Sirs,

Proposed takeover

Further to our conference call on 4 June 2015, we are writing to lay out the tax differences in effecting the acquisition under the two options considered:

Option 1: Acquisition of 100% of the share capital of Sun Sdn Bhd (Sun); and

Option 2: Direct purchase of the assets and liabilities of Sun's solar panel manufacturing business.

We will draw out the main tax differences by looking at the five key areas as seen below.

(i) Form of income derived from the investment by Planet Sdn Bhd (Planet)

Under Option 1, Planet will invest by way of acquiring the entire equity of Sun. In return, the income it derives from the investment will come in the form of a single-tier dividend from Sun. It is also reasonable to expect a dividend from year one as Sun is likely to make a profit of RM8·5 million in the year ended 31 May 2016.

Under Option 2, Planet will effectively commence a new business of manufacturing solar panels as it will acquire all the assets and liabilities of the manufacturing business previously owned by Sun. The investment return to Planet will come in the form of trading profits from this business source.

(ii) Deductibility of the interest expense for Planet

We understand that Planet will fund the investment by borrowing RM55 million from its non-resident parent company and the remaining RM20 million from a Malaysian commercial bank. Both loans will be interest-bearing.

Under Option 1, Planet will be exempt from tax on the single-tier dividend it will derive from Sun. Thus, it will not be able to deduct the interest expense from any dividend income because deduction of such an interest expense is specifically prohibited under the law [para 12B, Schedule 6].

Under Option 2, the loan of RM75 million will be deployed in acquiring the assets used in the manufacturing business in the production of gross income. Therefore, Planet will be able to claim a tax deduction in respect of its interest expense against the business profits from the manufacturing business [pursuant to s.33(1)(a)].

(iii) Transfer pricing (TP) issues

As Planet and Sun are unrelated parties, the RM75 million is the market value price negotiated between independent parties transacting at arms' length. RM75 million, being the cost of the shares or the assets of the manufacturing business, should therefore pass any TP scrutiny.

As regards the interest rates on the borrowings, the commercial bank loan should similarly clear any TP scrutiny.

However, the same cannot be said for the interest rate of 11·5% to be charged by the parent company on its RM55 million loan, especially when juxtaposed against the commercial bank loan rate of only 7%. Given the parent–subsidiary relationship and the obvious control factor, the higher interest rate is likely to attract query and a TP adjustment if a tax audit were to be carried out.

(iv) Trade receivables and inventory

Under Option 1, Sun will continue to own and operate the manufacturing business. Therefore, there will be no change in the tax treatment with regard to both the trade receivables and inventory.

Under Option 2, the manufacturing business will be transferred to Planet, a different entity, and the tax consequences are outlined below:

Trade receivables
The trade receivables transferred to Planet are book debts taken over which have not formed part of the gross income of Planet. Thereafter, any of such book debts becoming irrecoverable or doubtful will not rank for a tax deduction in Planet [pursuant to s.34(3)(a)]. By the same reasoning, Planet will not be taxable on any subsequent recovery of irrecoverable debts or write-back of an allowance for trade receivables relating to such taken-over book debts.

Inventory
The situation is one of Sun ceasing business and transferring its closing inventory to another person, Planet, who will use the transferred inventory in its business. As such, the amount (being a component of the RM75 million in respect of the transfer of the manufacturing business) attributable to the closing inventory on the date of transfer constitutes gross income to Sun as it represents the sale of inventory [pursuant to s.35(5)]. Correspondingly, Planet will be able to claim the same amount as its cost of purchasing the inventory [under s.33(1)].

There is no requirement to value the inventory at market value. Instead, the value of the inventory is the price paid or the value of the consideration received.

(v) Unabsorbed loss and capital allowance (CA) brought forward

Under Option 1, there is a substantial (in fact total) change in the shareholding of Sun when Planet acquires 100% of the shareholding. Nevertheless, as Sun is an active company, the denial of the carry forward of the unabsorbed loss and CA will not apply as such a denial is applicable only to a dormant company.

Therefore the unabsorbed loss and CA can be carried forward to be used in the subsequent years of assessment as the business remains in the hands of Sun.

Under Option 2, the manufacturing business within Sun effectively ceases with the transfer of the business to Planet. With the cessation, the unabsorbed CA are lost forever. As for the unabsorbed loss, Planet cannot take over the loss. Sun will continue to retain the loss which can be utilised against any business income it may have in the future.

(vi) Comparative computations

To better demonstrate the differences in the tax treatment under each option, we attach an appendix featuring the computation of the chargeable income of the manufacturing business for the year of assessment (YA) 2016 under each option. For illustrative purposes, we have assumed that the adjusted income for the YA 2016 is RM9·8 million and the CA for the current year is RM300,000 if the business remains owned by Sun (Option 1) and RM540,000 if the business is owned by Planet (Option 2).

As seen in the appendix, under Option 1, there is no interest expense deductible as Planet borrowed to finance the purchase of 100% shares in Sun. Under Option 2, Planet will have borrowed to acquire Sun's business, thereby qualifying for deduction of the interest incurred on the RM75 million.

Under Option 1, Sun is able to deduct the brought forward CA and loss so that the chargeable income is RM1,200,000. On the other hand, under Option 2, Planet can only deduct the current year CA of RM540,000 leading to a higher chargeable income of RM1,535,000.

[Tutorial note: *Going forward, Option 1 will no longer have any unutilised CA and losses. However, an interest deduction will continue to be available under Option 2. This single item of deduction will significantly reduce future taxable profits.*]

(vii) Tax planning advice/ideas

If you should decide to adopt Option 2, i.e. acquire the business assets and liabilities of Sun, there are three areas where you can strategise or rethink in order to achieve a better tax outcome:

Interest rate on parent company's loan
The proposed interest rate of 11·5% is markedly higher than the prevailing market rate in Malaysia. This should be reviewed and reduced to a rate nearer to 7%, which will then be more acceptable from a TP perspective. Thus, Planet may pre-empt potential issues and penalties in the event of any TP scrutiny.

Trade receivables taken over
You should alert the management of Sun to critically assess the list of trade receivables with a view to writing off/creating an allowance against any receivables which are irrecoverable or doubtful before the acquisition. In this way, Sun will be eligible for the relevant tax deductions, while Planet will only pay for the 'good' trade receivables. This is important because, as stated in (iv) above, Planet will not be able to claim any tax deduction for writing off any irrecoverable debts or creating any allowances for receivables in respect of the book debts taken over from Sun (as these debts have never constituted part of the gross income of Planet).

Closing inventory transferred to Planet
There is an opportunity to tax plan here, by attributing a higher amount (within the overall RM75 million purchase price) to the inventory transferred over. The increased value attributed to the inventory may be sheltered by the unabsorbed CA and losses brought forward. Planet will then be able to have a larger tax deduction in respect of the purchase of inventory. This is, of course, provided that the figure used approximates to the market value.

We hope you are now clear as to the tax consequences of each option. Please do not hesitate to contact us should you require further clarification.

Yours faithfully,

....
(Tax principal)

Appendix

Computation of the chargeable income of Sun's manufacturing business for YA 2016

		Option 1 Sun		Option 2 Planet
	RM'000	RM'000	RM'000	RM'000
Adjusted income before interest deduction		9,800		9,800
Less Interest expense		nil		(7,725)*
Adjusted income		9,800		2,075
Less CA				
Brought forward	1,500		nil	
Current year	300		540	
		(1,800)		(540)
Statutory income		8,000		1,535
Less Unabsorbed loss brought forward		(6,800)		nil
Aggregate/total/chargeable income		1,200		1,535

	RM
*RM55,000,000 at 11·5%	6,325,000
RM20,000,000 at 7%	1,400,000
	7,725,000

[**Tutorial note:** *The interest deductions under Option 2 assume that no TP adjustment is made in relation to the interest on the loan from Planet's parent company.*]

2 Inovasi Sdn Bhd

(a) Deductibility of the expense items

(i) Catering services expense of RM78,000

According to our file records, the catering (food and beverage) expense is for a product launch of the latest range of home appliances. Therefore, the expense qualifies for deduction [under s.33(1)] as it is wholly and exclusively incurred in the production of gross income from the manufacturing business.

However, the expense, being on food and beverage, is also caught under the definition of 'entertainment' [under s.18].

Under the law [s.39(1)(l)], generally, 50% of any entertainment expense is disallowed. However, if an entertainment expense item comes under any one of the exclusions to the said law, a 100% tax claim will be granted.

As the purpose of this entertainment expense is for the launch of new products, it is related wholly to sales. As such, the expense comes under one of the exclusions [proviso (vii)] to the prohibition of entertainment expense [under s.39(1)(l)]. Furthermore, this treatment is confirmed by the IRB in their Public Ruling [3 of 2008] on 'Entertainment'.

Therefore, the entertainment expense, being wholly related to sales, is eligible for a 100% tax deduction.

(ii) Commission of RM100,000

This payment was made to a non-resident for a sales introduction service. Hence, this does not fall under 'technical' services and is thus not caught as a special class of income [under s.4A].

The non-resident recipient operates a business of sales introductory services in Brazil. He charges a commission for introducing customers to businesses. This commission therefore constitutes business income to Mr Santiago.

Therefore, the commission does not fall under 'other income' [under s.4(f)] to Mr Santiago. As such, contrary to the IRB's assumption, the commission payment is not subject to withholding tax for 'other income' [under s.109F].

As Inovasi has not breached any withholding tax provisions, the payment of commission should be accorded a full 100% tax deduction.

(iii) Repair and maintenance of machinery of RM180,000

The engine overhaul is a routine repair scheduled every 24 months to keep the machinery in proper working order. It is therefore nothing more than proper and regular maintenance of a business asset. There appears to be no element of addition, enhancement or improvement.

The replacement is of the component parts only, not the entirety. Therefore, it is not capital in nature.

The expense of RM180,000, as an absolute amount, may appear substantial. However, when viewed against the cost of the asset, RM5 million, it is not a significant cost.

In conclusion, despite the substantial amount, the RM180,000 is a revenue expense for the maintenance of a business asset, and replacing parts thereof. Therefore, the entire sum of RM180,000 should be eligible for a 100% tax deduction.

(iv) Product improvement of RM1,250,000

The description 'product improvement' suggests an improvement element. However, in substance, the said expense is not for improvement of the products, but for testing the improved features of existing products.

The claim for tax deduction is based on it being wholly and exclusively incurred in the production of gross income [under s.33(1)], being merely testing expenses of existing products, and not falling under 'scientific research' [under s.34(7)] as the expense is not research *per se*.

Therefore, the expense of RM1,250,000 should be given a full 100% tax deduction.

(b) Penalty for incorrect return

Under the law [s.113(2)], the IRB is authorised to impose a penalty of up to 100% of the tax undercharged if no prosecution action is instituted in respect of an incorrect return. In this case, the 45% penalty is within the legal limit.

However, if the IRB concedes to the taxpayer's defence on all four items, there should be no penalty at all.

Moreover, Inovasi did not omit or understate any income, neither was there any misrepresentation nor non-disclosure. The facts show that Inovasi took reasonable care in the tax treatment of the four items.

Therefore, no penalty should be imposed.

(c) Valid appeal

For a valid appeal to the Special Commissioners of Income Tax, Inovasi must lodge its appeal in the prescribed form [Form Q] against the additional assessment within 30 days after the date of service of the additional assessment. For practical purposes, the date of service is normally taken to be the date stated on the notice of assessment, i.e. 5 May 2015. This would mean that the deadline for appeal is 4 June 2015.

As the notice of assessment and the letter from the IRB were only delivered to Inovasi on 30 May 2015, Inovasi has valid reasons for not being able to file its appeal within the said 30 days.

Therefore, Inovasi may apply to the Director General of Inland Revenue for an extension of time to submit its appeal against the additional assessment. The application must be made in a prescribed form [Form N] as soon as possible.

3 Best Sdn Bhd (Best) and Miss Rajin

(a) Change of accounting date

The last normal accounts are for the year of assessment (YA) 2014 covering the period 1 July 2013 to 30 June 2014.

In 2015, Best will fail to make up its accounts to the normal date and change to the new accounting date of 30 September.

Therefore, 2015 is the failure year and the Director General of Inland Revenue (DGIR) will direct the basis period for YA 2015.

Bearing in mind that the accounts will cover the period of 1 July 2014 to 30 September 2015, a period of 15 months ending in the year 2015, i.e. the year after the last normal accounts, the DGIR will direct [per paragraph 3.6.3 of the Public Ruling 7 of 2001] such that this will form the basis period for YA 2015.

As the next set of accounts is for the period 1 October 2015 to 30 September 2016, this will form the basis period for YA 2016 as the accounts are made up for a period of 12 months ending on a day other than 31 December in the basis year.

Thus, the basis periods for the two YAs will be:

YA 2015	1 July 2014 to 30 September 2015	(15 months)
YA 2016	1 October 2015 to 30 September 2016	(12 months)

In determining the basis periods as above, the underlying principles per Public Ruling [7 of 2001] are fulfilled:

(1) no accounting period or year of assessment will be left out; and

(2) there is no overlapping of basis periods.

(b) Permanent establishment (PE)

Under the terms of the OECD model double tax agreement, a PE is a fixed place of business through which the business of an enterprise is wholly or partly carried on. In addition, an agent of a company like Miss Rajin (Rajin) can constitute a PE if she has authority to conclude contracts on behalf of the enterprise, unless her activities are limited to the purchase of goods for Best. This is the concept of agency PE.

Rajin will be based full-time in China, travelling the country to source suppliers and customers on behalf of Best. The fact that Best will have no office or branch in China does not detract from the reality that Rajin will effectively be carrying out the core and integral trading activities of Best in China.

In addition, Rajin will be authorised to enter into business contracts on behalf of Best.

Rajin will be in China for 24 months, an extended period by any measure, to carry out these core activities. Her absences from China, for a week every three months, during that period will be brief. This suggests a degree of permanence which again is suggestive of a PE under the OECD model double tax agreement.

Hence, it is very likely that Best will have a PE in China through the presence of Rajin in China.

(c) Tax treatment of Best in Malaysia during the 24 months

Best's business is operated in Malaysia. The activities which occur outside Malaysia are incidental to its business operations in Kuala Lumpur. Therefore, all proceeds from the trading activities will constitute business income of Best derived from Malaysia and fully subject to tax in Malaysia, including those profits attributable to the Chinese PE.

At the same time, during the 24 months, Best is deemed to have a PE in China. Income attributable to the activities carried out by the PE will be income arising in China and thus is likely to be subject to tax in China.

Therefore, there is likely to be an issue of double taxation on this income attributable to the China PE which is still income derived from Malaysia. This will be resolved by the country of residence, i.e. Malaysia, giving double tax relief (DTR) to Best for the Chinese tax suffered. The Malaysia–China double tax agreement provides for relief from double taxation by credit and, therefore, Best will receive a credit for the Chinese tax suffered on the profits of the Chinese PE against its Malaysian tax on the same income. This credit for the Chinese tax suffered will be limited to the Malaysian tax on the same income.

(d) Tax treatment of Rajin in Malaysia for YA 2015, YA 2016 and YA 2017

Rajin's tax residence status will be as follows:

YA	Facts	Residence status
2015	Rajin will spend 182 days in Malaysia (1 January 2015 to 1 July 2015 plus her three monthly progress visits after this date). Even if less than 182 days are spent in Malaysia, it can be linked to a period of 182 or more consecutive days in 2014.	Resident [s.7(1)(a) or (b)]
2016	Rajin will spend four weeks in Malaysia (being her three-monthly progress visits): less than 90 days. However, she will be resident for the three immediately preceding YAs before and the YA after.	Resident [s.7(1)(d)]
2017	Rajin's stay in Malaysia for less than 182 days is mitigated by the fact that the period will be linked to a period of 182 or more days in Malaysia in 2018.	Resident [s.7(1)(b)]

Rajin will be a tax resident of Malaysia for all three YAs. Her rental income, being derived from Malaysia, will be subject to tax in Malaysia. Due to her residence status, Rajin will be accorded personal reliefs and charged to tax at the scale rates.

Her employment income during the 24 months she is in China will not be taxable in Malaysia because:

– The employment income is not derived in Malaysia as Rajin will not be exercising her employment in Malaysia, neither is her employment in China incidental to her employment in Malaysia (as she will not have any employment in Malaysia) (the source of employment income is where the services are performed – in Rajin's case; in China); and

– The employment income is therefore foreign income, and when remitted back to Malaysia, will be tax exempted specifically [under paragraph 28, Schedule 6].

4 The BnB Trust

(a) Artist – Income tax for the year of assessment 2014

(i) The RM1 million represents proceeds from the sale of artworks and constitutes gross income from a business to the artist as he regularly produces art pieces for sale to the public. When he transfers the RM1 million to the BnB Trust, it is a gift; a mode of application of his income. The artist will therefore be subject to income tax in respect of the RM1 million, being his business income.

The transfer of RM1 million to the BnB Trust represents a donation of money to a charitable trust which is not approved by the Director General of Inland Revenue (DGIR). Hence, the artist will not be eligible for a deduction in respect of this donation against his aggregate income [under s.44(6)].

(ii) If the artist were to transfer the RM1 million to an approved organisation, he would be able to claim a tax deduction against his aggregate income but subject to a maximum of 7% of his aggregate income. As the RM1 million is his only income for the year 2014, his aggregate income is RM1 million and the tax deduction would be RM70,000 (7% x RM1 million).

(b) The BnB Trust – Receipts from the provision of food and services to the homeless

Business income
It can be argued that the provision of food and services is a charitable objective to help the homeless.

In providing the one meal a day, shower and sleeping facilities, and medical attention to the homeless, it can be argued that the BnB Trust is effectively carrying on a business because:

– it provides the food and services for a consideration in money; and
– it organises human resource (both voluntary and paid) to carry out the business activities of cleaning, cooking, counselling and treating medically.

Accordingly, it is argued that the receipts constitute income from a business of providing food and shelter.

Other income
It can be argued that the nominal charges for the food and services represent receipts of an income nature: they are consideration for goods and services.

However, it can be argued that the receipts are not business income because there is no profit motive.

Therefore, they are argued to be other income [under s.4(f)].

Not income
It can be argued that the objective of operating the service centre is charitable, to help the homeless, rather than the expectation of making a profit.

The amount charged for the meals and services is merely a token, it is not proper market value consideration for the goods and services rendered. It is more in the nature of a partial reimbursement of expenses for which a tax deduction has not been given [s.22(2)(a)(i)].

Therefore, it is argued that the receipts are not revenue in nature and do not constitute income.

(c) The BnB Trust – Donations received

Income (arguments for)
The BnB Trust operates the service centre like a business, with the objective of providing food and services to the homeless in return for low charges. The trust therefore effectively runs a business of providing services to the homeless. Obtaining money to help fund the activities is therefore very much in tandem with this business objective.

Therefore, the donations received are 'income' in nature to the BnB Trust.

Not income (arguments against)
The donations are gifts of money by well-wishers with no expectation of consideration in return. They are not payment for the supply of goods or services or for the use of property, amenities or money.

Therefore, the donations are not 'income'.

(d) The BNB Trust – Tax computation for the year of assessment 2015

	RM	RM
Business income:		
Sale of meals and services	328,000	
Malaysian dividend (exempt)	nil	
Interest from Malaysian banks (separate source)	nil	
Donations	120,000	
		448,000
Less: Expenditure		
Cost of meals and services	400,000	
Utilities	36,000	
Trustees' remuneration 80% of RM12,000	9,600	
Salary to caretakers	43,200	
Depreciation	nil	
		(488,800)
Adjusted/statutory income		nil
Current year loss	40,800	
Interest income		3,000
Aggregate income		3,000
Less Current year loss	(3,000)	(3,000)
Unabsorbed loss carried forward	37,800	
Total/chargeable income		nil

5 ABC Sdn Bhd (ABC)

(a) (i) Conditions for reinvestment allowance and whether ABC fulfils them

(1) **The company is a resident company**
ABC is incorporated in Malaysia and carries on a business in Malaysia, i.e. control and management is exercised in Malaysia. Therefore, it is a resident company and so fulfills this requirement.

(2) **The company has been in operation for not less than 36 months**
36 months from the commencement of ABC's business operations (on 1 October 2012) is 30 September 2015. The completion of the new factory and the commissioning of the new machinery will happen in June and July 2015. Therefore, ABC will not have completed 36 months of operations and so will not fulfill this requirement at the time of incurring the relevant capital expenditure.

(3) **The company does not enjoy any other tax incentive in the year of assessment (YA) 2015**
There is no suggestion that ABC has enjoyed any tax incentives. Therefore, it can be assumed that ABC fulfills this requirement.

(4) **The company has embarked on a qualifying project of expansion, modernisation, automation or diversification**
ABC is expanding its production capacity, as business has been profitable. Therefore, it fulfills this requirement.

(5) **The company has incurred qualifying capital expenditure on a factory, plant and machinery in connection with a qualifying project**
ABC will incur qualifying capital expenditure in connection with the expansion by building a new factory and installing new machinery. Therefore, it will fulfill this requirement if it purchases the said machinery. However, if it decides to lease the machinery, the RM5·5 million of leasing costs will not constitute qualifying capital expenditure in respect of plant and machinery.

(ii) Maximisation of the reinvestment allowance claim

With reference to the requisite 36 months of operations, ABC will need to change its timescale: the completion of the new factory and installation and commissioning of the new machinery should be deferred to 1 October 2015 or later. This should not pose a problem as it only means a deferment of about three months.

This will mean that ABC will be eligible for the reinvestment allowance in YA 2016 as the expansion project and the qualifying capital expenditure will be incurred in the basis period for YA 2016.

With regard to the machinery, ABC should purchase not lease the machinery, as if the machinery is leased the RM5·5 million will then be treated as a revenue expense, not capital expenditure qualifying for the reinvestment allowance.

Assuming ABC purchases the machinery, the qualifying capital expenditure will be RM8·4 million (RM3·4 million + RM5 million) as opposed to RM3·4 million only. In this way, ABC can maximise its claim for reinvestment allowance.

(iii) Consequences of disposal in 2017

A condition of receiving the reinvestment allowance incentive is that the assets shall not be disposed of within five years from their date of acquisition [in paragraph 2A, Schedule 7A].

If ABC qualifies for the allowance in YA 2015 and then disposes of its manufacturing business in 2017, the assets will have been held for less than five years. If so, it will not satisfy this condition and it will be deemed that the reinvestment allowance has not been given, and any allowance given will be withdrawn.

[**Tutorial note:** *In practice, according to Public Ruling 6 of 2012, paragraph 9.2.4, Example 40, the reinvestment allowance thus given in YA 2015 will be withdrawn either by revising the tax computation for YA 2015 or by adding back the reinvestment allowance in the tax computation for YA 2017. In the Budget 2015, an amendment has been made to Schedule 7A to deem the reinvestment allowance withdrawn as statutory income in the basis period in which the disposal is made.*]

(b) Real property company (RPC) status

ABC is a controlled company as it has no more than 50 members and is controlled by not more than five persons. Therefore whether or not ABC is or is not an RPC will depend on whether it owns real property or shares valued at not less than 75% of its total tangible assets on the relevant date/s.

1 February 2012
On 1 February 2012, ABC was incorporated with a paid-up capital of RM2 million. On this date, the company had not acquired any real property and cash is its only tangible asset. Therefore, it is not an RPC on this date.

8 March 2012
On 8 March 2012, ABC acquired a piece of land for RM500,000. This warrants an assessment of whether it is an RPC. The only other tangible asset is the remaining cash of RM1·5 million (RM 2 million – RM500,000). Applying the formula of A/B x C, the calculation is as follows:

RM500,000/500,000 + 1,500,000 = 25% which is below the requisite 75%.

Therefore, ABC was not an RPC on 8 March 2012.

31 August 2012
On 31 August 2012, the factory building was completed. This was merely an enhancement expenditure, there is no acquisition of real property. Therefore, there is no requirement to reassess the RPC status. ABC was not an RPC on 31 August 2012.

30 June 2015
On 30 June 2015, the new factory building will have been completed, again on the existing land. There has been no acquisition of real property, hence no requirement to reassess the RPC status.

In conclusion, ABC remains a non-RPC during the whole of the material time.

		Marks
1	**Planet Sdn Bhd and Sun Sdn Bhd**	
(i)	**Form of income derived by Planet**	
	Option 1	1
	Option 2	1
		2
(ii)	**Deductibility of the interest expense for Planet**	
	Option 1	
	Exempt from tax on the single-tier dividend	1
	Cannot deduct the interest expense from any dividend income	0·5
	Because specifically prohibited under the law	0·5
	Option 2	
	Loan used to acquire business assets used to produce gross income	1
	Therefore, Planet can claim a tax deduction for the interest expense	1
		4
(iii)	**Transfer pricing (TP) issues**	
	RM75 million cost of assets, arms' length price, no TP issue	1
	Commercial loan, no TP issue, reason	1
	Parent company loan interest rate too high	1
	Control situation, related party, TP scrutiny likely	1
		4
(iv)	**Trade receivables and inventory**	
	Option 1: status quo, trade receivables and inventory	0·5
	Option 2	
	Trade receivables	
	Transferred to Planet, a different entity	0·5
	Book debts taken over have not formed part of the gross income of Planet	1
	Book debts turning irrecoverable or doubtful not deductible for Planet	0·5
	Any recovery or write-back also not taxable on Planet	1
	Inventory	
	Sun ceases business, and transfers closing inventory to Planet, who also uses inventory in business	0·5
	Amount attributable to the closing inventory constitutes gross income to Sun because sale of inventory	1
	Planet must adopt the same figure as its cost of purchasing inventory	0·5
	Need not value such inventory at market value	1
	Price paid or value of consideration is acceptable	0·5
		7
(v)	**Unabsorbed loss and capital allowance (CA) brought forward**	
	Option 1	
	Sun is active company, not dormant, shareholder continuity rule not applicable	1
	Therefore business remains with Sun	1
	Can carry forward both unabsorbed loss and CA	1
	Option 2	
	Transfer of business – Sun's manufacturing business effectively ceases	1
	With the cessation, unabsorbed CA is lost forever	1
	Planet cannot take over unabsorbed loss of Sun	1
		6

		Marks
(vi)	**Comparative tax computations**	
	Narrative:	
	Option 1	
	Sun has no interest expense	0·5
	Sun can deduct brought forward CA and loss	1
	Impact: lower chargeable income of RM1,200,000	0·5
	Option 2	
	Planet can deduct interest expense	0·5
	Can only deduct the current year CA of RM540,000	1
	Higher chargeable income of RM1,535,000	0·5
	Computations	3
	Available	7
	Maximum	5
(vii)	**Tax planning advice**	
	Interest rate	1
	Trade receivables	1
	Inventory – higher value	
	Increased deduction for Planet	1
	Sun can utilise unabsorbed CAs and loss against income	1
	Available	4
	Maximum	3

	Marks
Professional marks	
Format and presentation of the letter	1
Clarity, effectiveness of communication including logical flow	2
Appropriate use of appendix	1
	4
	35

	Marks
2 Inovasi Sdn Bhd	
(a) (i) Catering services expense	
Qualifies under s.33(1), with reason	1
Comes under the definition of 'entertainment'	0·5
General 50% prohibition explained	1
Included under exclusion [proviso (vii)], with reason	1
Treatment confirmed in public ruling	0·5
Conclusion: 100% deductible	1
	5
(ii) Commission payment	
Payment not for technical services, not s.4A	1
Recipient's business income	1
Therefore not 'other income'	0·5
Therefore no withholding tax (WHT) applicable	1
Accordingly, no breach of WHT provisions	0·5
Conclusion: fully deductible	1
	5
(iii) Repair and maintenance	
Routine maintenance, proper and regular	0·5
No addition, enhancement, improvement	1
Replacement of parts, not the entirety	1
Not capital	0·5
Not substantial compared to cost of asset	1
Conclusion: revenue, fully deductible	1
	5
(iv) Product improvement	
Testing of existing products, with reason, therefore not capital	1 + 1
Wholly and exclusively incurred in the production of gross income	1
Conclusion: tax deductible	1
	4
(b) Penalty for incorrect return	
Within legal limit	1
If defence agreed, no penalty	0·5
In any case, reasonable care taken, with reason	1
Conclusion: no penalty	0·5
	3
(c) Valid appeal	
The appeal provisions	1
Late delivery, valid reason for delay	1
Apply for an extension	1
	3
	25

		Marks
3	**Best Sdn Bhd and Miss Rajin**	
(a)	**Change of accounting date**	
	Identify failure year	1
	Basis periods for YA2015 and reason	1 + 1
	Basis period for YA2016 and reason	1 + 1
	Underlying principles	1
		6
(b)	**Whether there is a permanent establishment (PE)**	
	Definition of a PE – agency PE	1·5
	Core activities	1·5
	Power to enter into contracts	1
	Sufficient duration	1
	Conclusion	0·5
	Available	5·5
	Maximum	4
(c)	**Tax treatment of Best in Malaysia**	
	PE activities incidental to business operated in Malaysia, income derived from Malaysia	1.5
	PE – income also subject to tax in China thus DTR issue	0·5
	Resolution of double taxation by Malaysia	1
	Operation of DTR by credit	1
		4
(d)	**Tax treatment of Miss Rajin for YA 2015, 2016 and 2017**	
	Residence status for each YA, with reasons – 3 x 1	3
	Rental income taxable	0·5
	Eligible for personal reliefs and scale rates	0·5
	Employment income not derived in Malaysia, reason	1
	Remittance is exempt, with reason	1
		6
		20

		Marks
4	**The BnB Trust**	
(a)	**Artist – sale of artworks and donation of RM1 million**	
(i)	Business of selling artwork	1
	Transfer to trust is mode of application	0·5
	Artist is subject to tax in respect of RM1 million	0·5
	Not approved organisation: no deduction	1
		3
(ii)	Approved: deduction	1
	Restricted to 7%, amount	0·5 + 0·5
		2
(b)	**Receipts from the provision of food and services**	
	Business income	2
	Other income	2
	Not income	2
		6
(c)	**Donations received**	
	Income, reason	1·5
	Not income, reason	1·5
		3
(d)	**Tax computation of the BnB Trust**	
	Income items 0·5 x 2	1
	Exempt dividends	0·5
	Expenditure items 0·5 x 3	1·5
	Non-deductible expenditure x 1	0·5
	Trustees' remuneration, allowable, portion	1·5
	Adjusted income nil and current year loss	0·5
	Interest income as separate source	0·5
	Set-off of current year loss	0·5
	Carry forward balance	0·5
	Available	7
	Maximum	6
		20

			Marks
5	ABC Sdn Bhd		
(a)	**(i)**	**Conditions for reinvestment allowance and application to ABC**	
		Resident company	1
		Operation for not less than 36 months	1·5
		No other tax incentive	1
		Qualifying project	1
		Qualifying capital expenditure	1
		Purchase v lease	1·5
			7
	(ii)	**Maximisation of claim**	
		Defer completion/commissioning to 1 October 2015 or later	1·5
		Why feasible	0·5
		Relevant YA – YA 2016	1·5
		Acquire, not lease, with reason	1
		Maximum amount of claim	0·5
			5
	(iii)	**Disposal of business in 2017**	
		Minimum holding duration	1
		Holding period < minimum	0·5
		Consequences – withdrawal	0·5
			2
(b)	**RPC status**		
	Controlled company, with reason		1
	75% of total tangible assets test		0·5
	On 1 February 2012		1
	On 8 March 2012		1·5
	On 31 August 2012		1
	On 30 June 2015		1
			6
			20

Examiner's report
P6 Advanced Taxation (MYS)
June 2015

General Comments
The examination comprises 2 sections. Section A contained two compulsory questions: question 1 for 35 marks and question 2 for 25 marks. Section B required a response to two out of three questions of 20 marks each.

Most candidates attempted the required four questions, and there was no evidence of time pressure.

Candidates performed relatively well on questions 3 and 5. The question candidates found most challenging was question 4.   Answers to question 1 and question 2 were of mixed quality. This was mainly due to candidates not being able to apply their understanding of the fundamental tax principles sufficiently well.

A number of common issues arose in candidates' answers as follows:

- Failing to directly respond to the question requirement and instead providing general features of the technical topic, which scored few if any marks.

- Venturing into related but untested issues – for example:

    - when answering about the deductibility of interest expenses, many candidates automatically discussed the issue of "interest restriction" which was irrelevant;

    - in commenting about unabsorbed losses and capital allowance, many candidates wrote about eligibility for group relief, which was not relevant to the scenario

Specific Comments

Question One
This 35-mark question was based on an investment holding company, Planet, contemplating two options under which to acquire a manufacturing business operated by an unrelated company, Sun. The options were: 1) to acquire the entire share capital of Sun, or 2) to acquire the assets and liabilities of Sun's manufacturing business. To finance the acquisition, Planet would borrow from a Malaysian commercial bank and from its non-resident parent company. Candidates were required to prepare a letter to Planet to advise on the relative tax treatment of each option and to suggest some tax planning ideas.

Part (i), for two marks, required the identification of the type of income derived under each option. This was relatively well answered, although there were some candidates who missed the point being tested.

In Part (ii) pertained to the tax deductibility of interest expense under each option. A surprising number of candidates commented that the interest expense on a loan from a non-resident company or on a loan taken to invest in capital assets was not tax deductible. Such statements are, *per se*, incorrect. Additionally, many candidates discussed interest restriction and its mechanism, which is irrelevant in this context.

Part (iii) asked about transfer pricing issues. Many candidates regurgitated whole passages from the suggested solutions to an earlier exam question on transfer pricing, which were not relevant in the present context. Candidates are strongly discouraged from rote learning and giving stock answers: they should understand the principles so that they can apply them correctly to the specific scenario being tested.

Part (iv) on the trade receivables and inventory of Sun was reasonably answered, although frequently not succinctly enough and with unnecessary meandering through the subject matter, which would have wasted valuable time that could have been better spent elsewhere.

Part (v) tested how the unabsorbed capital allowances and losses accumulated under Sun's manufacturing business from prior years would be treated under each option. Many candidates correctly stated the tax treatment when Sun continued to operate the manufacturing business. However, many were not clear that such unabsorbed balances from prior years could not be transferred to Planet if it took over the manufacturing business (i.e. acquired the assets rather than the shares). This is an example of how candidates could not apply their knowledge of a basic tax principle to a given scenario. Some candidates even discussed the possibility of group relief, which was not possible since these are brought forward balances rather than current year losses.

Part (vi) invited candidates to calculate the comparative tax position under each option. While many candidates scored well here, a sizeable number of candidates were unsure of fundamental principles.

Part (vii) called for tax planning ideas/advice. Despite identifying the interest rate, trade receivables and inventory as the relevant areas, some candidates still were unable to respond correctly.

As regards professional marks, a surprising number of candidates did not provide the comparative computations in an appendix, separate from the main body of the letter.

Question Two

This 25-mark question featured an additional assessment after a tax audit which denied tax deduction to four expense items. Candidates were required to present arguments for the deductibility of these items, to comment on the penalty imposed for incorrect return and also on the procedure for a late appeal.

Part (a) (i) was about the treatment of a catering expense in connection with a product launch. Candidates tended to miss the central point that while the food and beverage were undeniably caught as an entertainment expense, a product launch is included in one of the provisos (exceptions), i.e. entertainment expense "related wholly to sales", which treatment was confirmed in the Public Ruling on entertainment expenses.

Part (a)(ii) pertained to the payment of commission to a non-resident for business introductions. Many candidates again missed the point that this was neither technical service fee nor "other income" because the facts clearly indicated that the commission constituted business income of the non-resident. This should have led to the conclusion that there was no failure to comply with the withholding tax provisions and therefore the commission payment should not be denied a tax deduction. Candidates' unsatisfactory performance here is unlikely to be an issue of a lack of technical knowledge as, it is considered likely that, if the question asked had been: "Given the facts, state whether withholding tax is applicable", candidates would have been able to answer. Candidates must take note that, at the professional level, it is imperative they know how to "apply" their tax knowledge to given scenarios.

Part (a)(iii) dealt with a repair and maintenance expense. This was generally well answered and candidates were able to differentiate between the replacement of parts and the entire asset.

Part (a)(iv) concerned the expense incurred on the testing of improved features of existing products. Many candidates could discern the difference between the improvement of existing products and developing new products.

Part (b) regarding the penalty for an incorrect return was not satisfactorily answered. Most candidates talked about the penalty for late submission, completely missing the incorrect return issue. This was clearly due to a failure to read the requirement with due care.

Part (c) related to an application for an extension of time to lodge an appeal against the additional assessment and was unsatisfactorily answered. Most candidates did not realise the significance of the postal delay and that on the day of the exam i.e. 5 June 2015, the 30 days for an appeal had already lapsed. It appears that many candidates did not know about the application for an extension of time to appeal against an assessment.

Question Three

This 20-mark question tested the change of accounting date by a trading company, Best, and presence of a permanent establishment (PE) in China by virtue of its placement of an employee, Miss Rajin, in China for 24 months and the tax position of Rajin.

The change of accounting date part was satisfactorily answered. This was a purely technical question which many candidates should have been able to tackle well. However, many candidates failed to maximise their marks as they did not offer the reasons or the underlying principles for the basis periods, despite the wording of the requirement.

The determination of whether there was a PE in China in part (b) was well answered. However, many candidates did not explain how double taxation occurs in part (c). Many candidates were not well versed with the source rules relating to business or employment income.

The residence status of Rajin in part (d) was well answered, with many correctly concluding that Rajin was resident for all the relevant years despite her 24-month time in China. This shows that candidates were able to apply their knowledge to the given scenario.

Question Four

This 20-mark question was based on a trust set up through a donation from an artist to provide essential services to the homeless at much reduced consideration. This tested the fundamental principles relating to "income", "business", "classification of income", "deductions", and included six marks for the computation of chargeable income of the trust.

The vast majority of candidates did not choose to answer this question, presumably avoiding it due to the inclusion of a trust in the scenario. This was another indication that candidates are not well prepared in applying basic tax principles.

The candidates who did attempt question 4 did so satisfactorily.

Question Five

This 20-mark question examined the reinvestment allowance with a small focus on the 36-month requirement. Candidates were required to state the eligibility criteria, how they were satisfied by ABC Sdn Bhd and advise as to how to maximise the claim for the allowance, the clawback on early disposal, and whether the company had become a real property company (RPC) at any time.

This question was fairly well answered except for the following points which were missed by many candidates:

(i) The 36-month period starts from the commencement of operations, not the date of incorporation;
(ii) The 36 months period is to be counted up to the date the qualifying capital expenditure is incurred;
(iii) It is necessary to ascertain the RPC status when a non-RPC company "acquires" real property or RPC shares;
(iv) Incurring enhancement costs, such as building a factory, on land already owned by the company is not tantamount to "acquiring" real property. Therefore it does not trigger the need to determine the RPC status by reference to the 75% rule.

Conclusion

Candidates must ensure that they fully understand the tax subject matter, and their preparation must also focus on the application of the technical rules learned.

Professional Level – Options Module

Advanced Taxation (Malaysia)

Thursday 10 December 2015

Paper P6 (MYS)

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

This question paper is divided into two sections:

Section A – BOTH questions are compulsory and MUST be attempted

Section B – TWO questions ONLY to be attempted

Tax rates and allowances are on pages 2–4

Do NOT open this question paper until instructed by the supervisor. During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.
This question paper must not be removed from the examination hall.

The Association of Chartered Certified Accountants

ACCA

SUPPLEMENTARY INSTRUCTIONS

1. You should assume that the tax rates and allowances shown below will continue to apply for the foreseeable future.
2. Calculations and workings should be made to the nearest RM.
3. All apportionments should be made to the nearest whole month.
4. All workings should be shown.

TAX RATES AND ALLOWANCES

The following tax rates, allowances and values are to be used in answering the questions.

Income tax rates

Resident individual
Chargeable income

	RM	RM	Rate %	Cumulative tax RM
First	5,000	(0 – 5,000)	0	0
Next	15,000	(5,001 – 20,000)	1	150
Next	15,000	(20,001 – 35,000)	5	900
Next	15,000	(35,001 – 50,000)	10	2,400
Next	20,000	(50,001 – 70,000)	16	5,600
Next	30,000	(70,001 – 100,000)	21	11,900
Next	150,000	(100,001 – 250,000)	24	47,900
Next	150,000	(250,001 – 400,000)	24·5	84,650
Exceeding	400,000		25	

Resident company

Paid-up ordinary share capital	First RM500,000	Excess over RM500,000
RM2,500,000 or less	20%	25%
More than RM2,500,000	25%	25%

Non-residents

Company	25%
Individual	25%

Labuan entity – income from a Labuan trading activity

All chargeable profits	3%

Trust body – resident or non-resident

All chargeable income	25%

Personal deductions

		RM
Self		9,000
Disabled self, additional		6,000
Medical expenses expended for parents	(maximum)	5,000
Medical expenses expended on self, spouse or child with serious disease, including up to RM500 for medical examination	(maximum)	6,000
Basic supporting equipment for disabled self, spouse, child or parent	(maximum)	6,000
Purchase of sports equipment	(maximum)	300
Study course fees for skills or qualifications	(maximum)	5,000
Expenses on books for personal use	(maximum)	1,000
Spouse relief		3,000
Disabled spouse, additional		3,500
Child – basic rate	(each)	1,000
Child – higher rate	(each)	6,000
Disabled child	(each)	6,000
Disabled child, additional	(each)	6,000
Life insurance premiums and contributions to approved funds	(maximum)	6,000
Private retirement scheme contributions, deferred annuity premiums	(maximum)	3,000
Medical and/or education insurance premiums for self, spouse or child	(maximum)	3,000
Purchase of a personal computer	(maximum)	3,000
Deposit for a child into the National Education Savings Scheme	(maximum)	6,000

Rebates

Chargeable income not exceeding RM35,000	**RM**
Individual – basic rate	400
Individual entitled to a deduction for a spouse or a former wife	800

Capital allowances

	Initial allowance (IA) Rate %	Annual allowance (AA) Rate %
Industrial buildings	10	3
Plant and machinery – general	20	14
Motor vehicles and heavy machinery	20	20
Office equipment, furniture and fittings	20	10
Agriculture allowance		
Buildings for the welfare of or as living accommodation for farm employees	nil	20
Other buildings used in the business	nil	10
All other qualifying agricultural expenditure	nil	50

Real property gains tax

	Companies	Individuals – Non-citizens and non-permanent residents	All others
	Rate %	Rate %	Rate %
Category of disposal			
Disposal within three years after the date of acquisition	30	30	30
Disposal in the fourth year after the date of acquisition	20	30	20
Disposal in the fifth year after the date of acquisition	15	30	15
Disposal in the sixth year after the date of acquisition or thereafter	5	5	0

Goods and services tax (GST)

Standard rate	6%

Stamp duty

Rates of duty under the First Schedule
Conveyance, assignment, transfer or absolute bill of sale

	Rate %
Sale of property	
For every RM100 or fractional part thereof:	
On the first RM100,000	1
On the next RM400,000	2
On the excess over RM500,000	3
Sale of company shares	
On every RM1,000 or fractional part thereof	0·3

Section A – BOTH questions are compulsory and MUST be attempted

1 Last week, your tax manager attended a meeting with Encik Ahmad, the finance director of Going Places Sdn Bhd (GP). GP is a stand-alone company wholly owned by members from an extended family, who are all tax residents of Malaysia. GP has been operating a private transport business for the past five years and has just started to be profitable in the financial year ended 30 September 2015.

Below are extracts of the notes of the client meeting and the email from your tax manager.

Extracts from the notes of the client meeting

GP needs to raise an additional RM1 million to purchase new equipment and is considering the best way to do this. GP is currently a small and medium enterprise (SME) for tax purposes.

The financial statements of GP for the year ended 30 September 2015 indicate the following:

- authorised and paid up share capital of RM2 million;
- bank borrowings of RM7 million at 8·5% interest per annum;
- retained earnings of RM1·45 million; and
- interest expenses of RM595,000.

All borrowed moneys have been used for business purposes. The high interest expense has prevented GP from distributing dividends thus far.

To eliminate the interest expense, GP is considering increasing its authorised share capital significantly by offering a rights issue to its shareholders to raise an additional RM8 million in the financial year ended 30 September 2016. The amount raised will be used to fully repay the bank borrowings and also to acquire 800 units of equipment. The units will each cost RM1,250 and be used to monitor the goods transported by GP. Of the equipment's total purchase cost of RM1 million, RM600,000 will be incurred by 30 September 2016 while the remaining RM400,000 will be spent in early 2017. There will be penalties and fees incurred in relation to the premature repayment of the bank borrowings.

GP forecasts a net profit (before interest expense and tax) of RM2·25 million for the year ended 30 September 2016. It proposes to distribute an annual dividend of 7% in each of the next three years.

Encik Ahmad wants to know the tax treatment of the expenditure incurred in connection with the increased authorised share capital, the rights issue, the premature repayment of the bank borrowings and the impact on GP's SME status for tax purposes.

Additionally, Encik Ahmad has requested explanations for GP's current shareholders as to the relative merits of investing in additional shares in GP as compared to placing their money in fixed deposits in commercial banks in Malaysia.

As an alternative, if GP decides not to pursue the rights issue, Encik Ahmad has indicated that the company will take out additional bank borrowings to fund the acquisition of the equipment.

Extracts from the email from your tax manager

Please draft a report to Encik Ahmad regarding the proposed rights issue which considers the effect of the two alternative methods of financing:

Option 1: Debt financing – Increase the current bank borrowing by RM1 million (to RM8 million) at the same interest rate and maintain GP's paid up share capital at the original RM2 million; or

Option 2: Equity financing – Increase the paid up share capital to RM10 million by way of a rights issue and repay all borrowings as outlined in the notes from the client meeting.

The report should address the following issues:

(i) The form and quantum of the cost of the financing/pay-out under each option.

(ii) The income tax treatment of

- the incidental costs of raising the debt/equity finance;
- the cost of premature repayment of the bank borrowings; and
- the interest expense or the dividend to be distributed.

(iii) In respect of year of assessment (YA) 2016 and YA 2017, whether GP will retain its SME status under each option (with reasons) and the attendant tax treatment.

(iv) In respect of YA 2016, a comparison of GP's retained earnings **after** taking into account the interest expense, tax payable and dividend distribution under the two options and your advice on which should be the preferred option.

Note: For the purpose of these computations you should assume that the tax adjusted income for the business for YA 2016 will be RM2·25 million **before** deducting the interest expense, and that capital allowances (CA) are only available in respect of the equipment acquired in the current year.

(v) Whether, under option 2, GP will be in a position to distribute the proposed 7% dividend in each of the next three years.

(vi) The relative benefits to an individual shareholder of GP of investing, say, RM1 million in:

- a fixed deposit in a commercial bank in Malaysia with an interest rate of 4% per annum; or
- acquiring additional shares in GP under the proposed rights issue; and your advice on the likely preferred option.

Required:

Draft the report to Encik Ahmad, the finance director of Going Places Sdn Bhd, as requested by your tax manager. The following marks are available:

(i) The form and quantum of the cost of financing/pay-out. (2 marks)

(ii) The income tax treatment of the two financing options. (8 marks)

(iii) The company's small and medium enterprise (SME) status and treatment. (7 marks)

(iv) The preferred option in terms of the company's retained earnings. (8 marks)

(v) The proposed dividend distribution under option 2. (2 marks)

(vi) The position of the individual shareholders. (4 marks)

Professional marks will be awarded in question 1 for the appropriateness of the format and presentation of the report and the effectiveness with which the information is communicated. (4 marks)

(35 marks)

2 A legal firm, LoyarBaik, has referred two potential clients, Mr Chong and Mr Mano, to the tax firm where you are the assistant manager. Below is the information made available by LoyarBaik in their brief and a note from your tax director.

Extracts from LoyarBaik's brief

We act for Mr Chong (Chong) and Mr Mano (Mano). Chong and Mano are Malaysian resident individuals who together hold the share capital of three companies – Bapak Sdn Bhd, Anak Sdn Bhd and Cucu Sdn Bhd – in the ratio of 60% (Chong) to 40% (Mano).

All three companies have paid up ordinary share capital of RM3 million and make up their accounts annually to 30 June. None of the three companies have enjoyed any form of tax incentive in the past.

Further information on each of the three companies is outlined below:

1. Bapak Sdn Bhd (Bapak) – Bapak was incorporated on 2 January 2013 and acquired its first tangible asset, 700 acres of land, on 8 January 2013. Bapak proceeded to plant and operate 450 acres of the land as an oil palm plantation. The remaining 250 acres of land was leased to Anak Sdn Bhd (see (2) below) for an annual rent which yields a positive income flow. Bapak expects to register good annual profits from its oil palm plantation business from the year of assessment (YA) 2016 onwards but has unabsorbed agricultural allowances (AA) and capital allowances (CA) brought forward from YA 2015.

2. Anak Sdn Bhd (Anak) – Anak was incorporated on 1 March 2013. On 1 July 2013, Anak commenced to own and operate a fleet of lorries which transport the primary produce and other supplies for Bapak.

   Since 1 July 2013, Anak has also operated a 250-acre rubber plantation on the land leased from Bapak. As part of this business activity, Anak incurred qualifying agricultural expenditure (on assets used for the clearing of land and new planting) as well as acquiring other items of plant and machinery in the year ended 30 June 2014.

   There are losses and unabsorbed AA and CA brought forward from YA 2015 in respect of both the transport business and the rubber plantation business. Based on current projections, neither of these businesses is expected to return a profit for at least three years.

   In addition, Anak provides book-keeping and accounting services for itself, Bapak and Cucu Sdn Bhd (see (3) below). This service activity has always been profitable and does not have any unabsorbed CA.

3. Cucu Sdn Bhd (Cucu) – Cucu was incorporated on 1 April 2013 and has been performing services relating to human resources and ICT (information, communication and technology) for itself, Bapak and Anak since 1 July 2013. Cucu's business has yet to make a profit, but it is expected to do so within the next two years. There are losses and unabsorbed CA brought forward from YA 2015.

Chong and Mano now want to embark on a corporate exercise to rationalise and streamline the operations of the three companies in order to render them more efficient and effective from both a business and a tax perspective.

As their legal advisers, we have proposed a revised structure as follows:

- Incorporating a new company (NewCo) with a paid up share capital of RM5 million, which Chong and Mano will hold in the ratio of 60%:40%.
- NewCo will hold 100% of the share capital of the three existing companies and provide treasury services to them.
- Bapak will focus on operating all the plantations.
- Anak will become a logistics (transport, supply, procurement) company for the plantations.
- Cucu will perform shared services relating to human resources, book-keeping, accounting and ICT functions.
- No inventory or trade receivables will be transferred.

We expect to commence the corporate rationalisation exercise shortly before transferring the shares of the three companies to NewCo on 15 January 2016.

We would like your firm to advise us on the tax implications of the proposed restructure.

Note from your tax director

I will be meeting with LoyarBaik next week regarding the proposed rationalisation exercise.

In preparation for this meeting, please carry out the following work:

(a) Identify the existing income streams which will cease or be transferred and the new income streams which will commence as a result of the rationalisation exercise. Explain the treatment of any losses, unabsorbed AA and CA brought forward from YA 2015.

(b) Explain the capital allowance implications resulting from the transfer of the rubber plantation business and business assets by Anak to Bapak.

(c) Explain the real property gains tax implications for Chong and Mano of the transfer of their shares in the three existing companies to NewCo.

(d) Identify the inter-company payments arising after the rationalisation exercise and comment on their tax deductibility and any other related tax issue(s) of which the company's management should be aware.

(e) Explain whether and, if so, when the group of companies will be eligible for group relief.

Required:

Carry out the work as instructed in the note from your director.

The following marks are available:

(a) Income streams and the treatment of losses and unabsorbed agricultural allowance/capital allowance brought forward. (7 marks)

(b) Transfer of the rubber plantation business/business assets. (6 marks)

(c) Transfer of Chong and Mano's shares to NewCo. (4 marks)

(d) Inter-company payments after the rationalisation. (4 marks)

(e) Group relief. (4 marks)

(25 marks)

Section B – TWO questions ONLY to be attempted

3 Esther is the marketing director of Intan Berhad (Intan), a company which makes up its accounts annually to 31 December and is listed on the Bursa Malaysia. On 1 June 2014, Esther was granted an option to purchase 20,000 ordinary shares in Intan, under its employee share option scheme (ESOS).

The offer price per share under the scheme is RM1·80. 50% of the shares offered vested on 1 August 2014 whilst the remaining 50% of the shares vested on 1 August 2015. The scheme allows employees 12 months from the vesting date to exercise their options.

Esther exercised her options as follows:

30 December 2014	She exercised all her entitlement at the first vesting date. Esther subsequently sold all of these shares on 2 July 2015.
4 November 2015	She exercised all her entitlement at the second vesting date. In order to finance the purchase of these further shares, Esther has taken out a bank loan. The bank interest payable by Esther for the calendar year 2015 is RM800.

On 1 December 2015, Intan made the following dividend distributions:

– a cash dividend of RM0·15 per ordinary share held; and
– a dividend *in specie* of shares in a subsidiary company.

On 30 December 2014, when Esther exercised her option to acquire the first tranche of shares, Intan issued new shares for transfer to Esther under the ESOS.

On 4 November 2015, when Esther exercised her option to acquire the remaining 10,000 shares, Intan transferred treasury shares to Esther. Intan had repurchased these shares on the open market on 28 July 2014 for RM1·95 per share. In acquiring the treasury shares, Intan incurred brokerage fees and took out an interest-bearing bank loan to finance the acquisition.

The market values of the ordinary shares of Intan on the relevant dates are as follows:

Date	Market value per share (RM)
1 June 2014	1·85
1 August 2014	2·00
30 December 2014	2·20
2 July 2015	2·50
1 August 2015	1·90
4 November 2015	2·30

Required:

(a) **Calculate Esther's taxable benefits in respect of the exercise of her entitlements under the employee share option scheme (ESOS) on 30 December 2014 and 4 November 2015, respectively. State the year of assessment in which the ESOS benefit would be subject to tax.** (6 marks)

(b) **Explain the income tax treatment of the following:**

(i) **the gain arising from the disposal of shares by Esther on 2 July 2015;**
(ii) **the cash dividend and dividend *in specie* received by Esther on 1 December 2015; and**
(iii) **the bank interest expense paid by Esther for the acquisition of the shares on 4 November 2015.** (6 marks)

(c) **In respect of Intan Berhad, explain whether or not a tax deduction will be available for the employee share expenditure relating to the ESOS where the share award is satisfied through:**

(i) **the issue of new shares; and**
(ii) **the transfer of treasury shares.**

Note: Your answer should explain both the basis of determining the quantum of any tax deduction and the timing of any tax deduction. (8 marks)

(20 marks)

4 David acquired an unfurnished bungalow unit from his brother, Solomon, in 2011. There was no written agreement concluded in relation to the purchase. The agreed consideration of RM1,800,00 was paid to Solomon in full on 15 August 2011 and the title of the property was transferred to David on 28 December 2011. The stamp duty payable on the transfer was RM48,000. Immediately after the acquisition, David rented out the bungalow to a tenant until December 2013.

In 2012, David received compensation of RM10,000 from his neighbour for causing damage to the fence of the bungalow. David attempted to sell the bungalow in 2013 but the sale was subsequently aborted. David forfeited the purchaser's initial deposit of RM20,000.

From 1 January 2014 to 1 March 2014, the bungalow was unoccupied, but David maintained it in good condition and ready to be let out. From 1 March 2014, David let out the bungalow to a car dealer who used it as a showroom. The rental agreement required the tenant to pay RM96,000, being one year's rental in advance, on moving into the property. In order to obtain this letting, David had to incur renovation costs of RM150,000 and to install air conditioners worth RM30,000 by 1 March 2014.

For the calendar year 2014, David also incurred the following expenses:

	RM
2014 quit rent and assessment	1,200
Roof repair (incurred on 20 November 2014)	1,500
Mortgage interest	18,000

In 2015, the car dealer (tenant) decided to acquire the property from David for an amount of RM3,500,000 (inclusive of furnishings valued at RM20,000). Consequently, no further rent was paid by the tenant but David continued to incur quit rent and assessment and mortgage interest costs for the period up to 28 February 2015 of RM1,000 and RM15,000 respectively.

The sale and purchase agreement for the property was signed on 1 March 2015 and approval from the State Authority to transfer the property was obtained on 30 May 2015. The full consideration was received on 1 August 2015 and the title of the property was transferred on 20 October 2015. David incurred legal fees of RM30,000 in relation to the disposal.

Required:

(a) (i) Compute the statutory rental income of David for the year of assessment 2014.

Note: You should clearly explain the tax treatment of every item of expenditure relating to the letting of the property in 2014 and should indicate by the use of the word 'nil' any item which is not included in the calculation of statutory rental income. (5 marks)

(ii) Explain the tax treatment of the quit rent and assessment and mortgage interest costs incurred by David in 2015. (3 marks)

(b) (i) State David's disposal and acquisition dates of the bungalow property for the purposes of real property gains tax (RPGT) and explain the basis on which these are determined. (4 marks)

(ii) Compute the RPGT payable by David in relation to the disposal of the bungalow property to the car dealer. (8 marks)

(20 marks)

5 **(a)** The Inland Revenue Board (IRB) commenced an audit of Timah Sdn Bhd (Timah) on 15 December 2014 covering the year of assessment (YA) 2009 and YA 2010. Based on the audit findings, the IRB disallowed the reinvestment allowance (RA) claims in respect of some of the assets acquired by Timah on the basis that the assets had not been acquired in respect of a qualifying project. The IRB issued notices of additional assessment for both YA 2009 and YA 2010 to Timah on 30 November 2015.

Timah has the production reports to support that the manufacturing capacity of the company increased following the acquisition of the assets in question and, therefore, intends to appeal against the notices of additional assessment.

Required:

Explain to Timah Sdn Bhd the procedures involved in submitting an appeal to the Inland Revenue Board. Your answer should include the following:

- **the deadline for submission of an appeal;**
- **how the appeal should be made; and**
- **the grounds of appeal which should be submitted in respect of both the year of assessment (YA) 2009 and YA 2010.** (7 marks)

(b) Muthu, a sole proprietor, did not submit a tax return for the year of assessment (YA) 2014 on the basis that his business had suffered losses in 2014 and so he should not have any tax liability.

The Director General of Inland Revenue has, according to his best judgement, determined the amount of the chargeable income of Muthu and proceeded to issue an assessment for an amount of RM150,000 for YA 2014. In addition, a penalty for non-submission of a tax return of RM10,000 was imposed.

Required:

Advise Muthu on whether he can appeal against the estimated assessment, and, if so, how he should proceed to appeal to the Director General of Inland Revenue to discharge the assessment, including the penalty imposed. (3 marks)

(c) Cekap Sdn Bhd (Cekap) was incorporated on 14 September 2014 with a paid up share capital of RM5,000,000. Cekap made up its first set of accounts to 30 September 2015. The funds from the issued share capital were placed in a short-term deposit account on 1 October 2014. The estimated interest income for the first year is RM120,000 and Cekap submitted its initial tax estimate based on this projected income.

On 1 February 2015, Cekap commenced its business of trading computer equipment. Based on a projection of income done in February 2015, the company's estimated tax liability for the first accounting period ending 30 September 2015 was RM1·2 million. However, on 1 May 2015, Cekap managed to secure a major contract from the Government. With this contract, the projected tax liability has increased to RM1·5 million.

Required:

(i) **Identify the date of commencement of operations for each of the sources of income derived by Cekap Sdn Bhd.** (1 mark)

(ii) **Explain the requirements on Cekap Sdn Bhd relating to the submission of tax estimates (including any revised tax estimates) and the payment of tax instalments for the year of assessment 2015. State, with reasons, whether or not, in view of the increase in its projected tax liabilities, the company should have revised its tax estimates and, if so, when.** (9 marks)

(20 marks)

End of Question Paper

1 Report to Going Places Sdn Bhd

To Encik Ahmad, finance director, Going Places Sdn Bhd (GP)
From Tax manager, Tax firm
Date 10 December 2015
Re Proposed refinancing plans

This report will serve to lay out the relative merits of debt financing (Option 1) compared with equity financing (Option 2).

Under Option 1, GP will maintain its paid up share capital at RM2 million but will increase its bank borrowings from RM7 million to RM8 million.

Under Option 2, GP will increase its paid up share capital from RM2 million to RM10 million, and repay the existing bank loans so that it will not have any borrowings.

We will consider the main tax differences under four key areas as set out below:

(i) Form and quantum of the financing cost

Under Option 1, GP will pay interest on bank borrowings of RM8 million. The interest expense will be RM680,000 (RM8 million x 8·5%) per annum. GP will also pay dividends to its shareholders of RM140,000 (RM2 million x 7%) in each of the next three years.

Under Option 2, there will be no interest expense but GP will pay dividends to its shareholders. The distribution involved will be RM700,000 (RM10 million x 7%) in each of the next three years.

(ii) Income tax treatment of the expenses

Under Option 1, the incidental costs of raising an additional loan of RM1 million will not rank for tax deduction as it is capital in nature. The interest of RM680,000 per annum incurred on the loan of RM8 million (RM7 million + RM1 million) will be tax deductible as the money borrowed will be used for business purposes. The distribution of RM140,000 will not be tax deductible as it represents profit distributed after tax.

Under Option 2, increasing the authorised share capital from RM2 million to RM10 million will involve additional statutory duty and professional fees. The rights issue leading to an additional RM8 million of paid up share capital will also involve incidental costs. These costs are all capital in nature as they relate to the capital structure of the company. As such, they will not be eligible for a tax deduction. The pay-out for this mode of financing is a dividend to the shareholders. The distribution of RM700,000 will not be tax deductible as it represents profit distributed after tax.

The costs of premature repayment of the RM7 million bank borrowings (including premature repayment penalties) will also be capital in nature, and as such, not deductible for tax purposes.

(iii) Small and medium enterprise (SME) status and attendant tax treatment

Option 1
Under Option 1, GP will not increase its paid up share capital. Therefore, it will remain an SME for tax purposes for the year of assessment (YA) 2016. The reasons are:

– at the beginning of the basis period for the YA 2016, i.e. on 1 October 2015, the paid up share capital of GP remains at RM2 million, which is below the prescribed RM2·5 million threshold for an SME; and
– GP is a stand-alone company, i.e. it has no parent company or subsidiaries which may have a paid up capital of more than RM2·5 million.

Therefore, GP will be a SME for tax purposes for YA 2016 and YA 2017.

The attendant tax treatment will therefore be as follows:

Capital allowance (CA) of 100% may be claimed in respect of the RM600,000 spent on small value assets in YA 2016, as each unit will cost no more than RM1,300. There is no restriction to the maximum of RM13,000. For YA 2017, a 100% CA claim in respect of the RM400,000 spent on small value assets will similarly be available.

The income tax rate of 20% is applicable for YA 2016 and YA 2017 for the first RM500,000 of GP's chargeable income while the chargeable income in excess of RM500,000 will be taxed at 25%.

Option 2
Under Option 2, GP increases its paid up share capital to RM10 million after 1 October 2015. Therefore, while the SME status remains intact for YA 2016, GP is no longer an SME in YA 2017, as its paid up share capital has increased to RM10 million by 1 October 2016, the beginning of the YA 2017 basis period.

CA at 100% may be claimed on small value assets on the full RM600,000 for YA 2016. However, for YA 2017, the 100% CA claim is only applicable to RM12,500 (RM1,250 x 10). The balance of RM387,500 will be subject to normal CA rates of 20% (initial allowance) and 10% (annual allowance).

Also, the income tax rates of 20% and 25% will apply only for YA 2016. The standard income tax rate of 25% will apply to all chargeable income for YA 2017.

(iv) Comparative computations

To better demonstrate the differences in the tax treatment under each option, we attach an appendix featuring the respective computation of the profit after tax for YA 2016. For illustrative purposes, we have assumed that the adjusted income for the YA 2016 is RM2·25 million and that the only qualifying expenditure for the purposes of CAs is in respect of the new small value business assets acquired in YA 2016.

As seen in the appendix, debt financing under Option 1 affords a full tax deduction in respect of the interest expense. This leads to a reduced chargeable income and a reduced tax charge.

Under Option 2, there is no interest expense deductible as the bank borrowings will have been repaid. The chargeable income and tax charged are, therefore, relatively high. Nevertheless, the equity financing under Option 2 produces a much higher net profit after tax of RM1,862,500 compared to RM1,352,500 under Option 1. Furthermore, after the dividend distribution based on the enlarged share capital, the residue of RM1,162,500 under Option 2 is not that far off the RM1,212,500 under Option 1. Therefore, Option 2 works out more favourable for the shareholders.

On balance, however, Option 1 is more favourable for the company because it results in a considerably lower tax charge which, coupled with a lower dividend (because of the smaller capital base), results in higher retained earnings.

(v) Dividend distribution – Option 2

GP may pay a dividend to the extent that it has sufficient retained earnings. Given its expected paid up share capital of RM10 million, the 7% dividend for the three years will add up to RM2·1 million (RM700,000 x 3). Retained earnings of RM1·45 million have already been accumulated. If the forecast net profit after tax of RM1·8625 million for 2016 (appendix) is added to this, there will be sufficient retained earnings to support the payment of the proposed dividends.

(vi) Tax treatment for shareholders

If RM1 million is placed in a fixed deposit at a commercial bank, the yield will be 4% and the interest received will be tax exempt as the shareholders are all individuals resident in Malaysia. The net amount of income received will be RM40,000 (RM1 million x 4%).

If the RM1 million is invested in shares in GP, the dividend yield is expected to be 7%. This amount is also exempt from tax in the hands of the shareholders because it is a single tier dividend. The net amount of income received will be RM70,000 (RM1 million x 7%).

The principal sum of RM1 million as a fixed deposit in a commercial bank is likely to decrease in present value terms although the principal sum is secure. The principal value of the shares may increase or decrease over time, depending on the performance of the business and market conditions.

On balance, investing the RM1 million in GP shares is therefore likely to be the better option although it is a higher risk investment and, therefore, the choice will depend on the individual shareholder's risk appetite.

– End of report –

Appendix

Computation of the profit after tax and after dividend distribution for YA 2016

	Option 1 Debt financing RM'000	Option 2 Equity financing RM'000
Adjusted income before interest deduction	2,250	2,250
Less: Interest expense	(680)	nil
Adjusted income	1,570	2,250
Less: CA		
Current year	(600)	(600)
Statutory/aggregate/total/chargeable income	970	1,650
Tax charged:		
First RM500,000 at 20%	100·0	
Remaining RM470,000 at 25%	117·5	
Total tax charged (Option 1)	217·5	
First RM500,000 at 20%		100·0
Remaining RM1,150,000 at 25%		287·5
Total tax charged (Option 2)		387·5
Net profit before interest and tax	2,250	2,250
Less: Interest	(680)	nil
Less: Tax	(217·5)	(387·5)
Net profit after tax	1,352·5	1,862·5
Dividend distributed: RM2 million at 7%	(140·0)	
Dividend distributed: RM10 million at 7%		(700·0)
Retained earnings after tax and after dividend	1,212·5	1,162·5
Retained earnings b/f	1,450	1,450
Total retained earnings	2,662·5	2,612·5

2 Bapak Sdn Bhd, Anak Sdn Bhd, Cucu Sdn Bhd and NewCo

(a) Income streams which will cease, be transferred and commence

Bapak

Bapak Sdn Bhd (Bapak) will cease to receive lease rental income from the leasing of the rubber plantation land to Anak Sdn Bhd (Anak).

The rubber plantation income source will be transferred from Anak to Bapak. On the transfer of the rubber plantation business, Anak will cease to derive income from the rubber plantation which has brought forward losses and unabsorbed agricultural allowances (AA) and capital allowances (CA). The losses will remain with Anak, and will be available for offset against the future income from Anak's ongoing business of logistics. However, following the transfer, when Anak ceases to receive income from the rubber plantation, the unabsorbed AA and CA attributable to the ceased plantation source will be lost.

There are two possible treatments of the rubber plantation business once it has been transferred to Bapak:

(1) The oil palm and rubber plantations are treated as a single plantation business. In this case, Bapak will be treated as having an enlarged plantation business comprising oil palm and rubber crops and Bapak will be able to claim the unabsorbed AA and CA brought forward from its old (oil palm) source against this new, enlarged source.

(2) The oil palm and rubber crops are considered separate and distinct in terms of processes and management. In this case, the respective plantation AA and CA will be contained under each crop/business and Bapak will only be able to use the unabsorbed AA and CA brought forward from its old (oil palm) source against future income from its oil palm plantation business [**Note:** *This distinction is unlikely to be of significance in the initial years when it is anticipated that the rubber plantation will not return a profit. However, it will be of more importance once the rubber plantation becomes profitable, if there are still unabsorbed AA and CA brought forward from the oil palm plantation.*]

Cucu

Anak will also transfer its book-keeping and accounting business to Cucu Sdn Bhd (Cucu). Cucu will add these transferred book-keeping and accounting services to its existing business activities comprising human resources and ICT services. No new business will be created as the add-on operations of book-keeping and accounting services may reasonably be treated as part of the shared services business currently run by Cucu. Therefore, the brought forward losses and unabsorbed CA from Cucu's existing business source may be offset against the enlarged source. [*The business transferred from Anak is profitable, so will have no brought forward losses or unabsorbed CA.*]

NewCo

The treasury services provided to the three companies will bring a new source of interest income to NewCo. This income will necessarily be treated as interest income [under s.4(c)] rather than business income because of the deeming provision [s.4B].

(b) Transfer of the rubber plantation business and business assets

The transfer of Anak's rubber plantation business and plantation assets to Bapak will happen within five years of the relevant assets' acquisition, so this will result in an agriculture charge in respect of the agricultural assets relating to the clearing of the land and new planting. Similarly, the transfer of the plant and machinery will attract balancing adjustments on disposal.

However, this transfer of assets will be subject to the controlled sale provisions because Bapak and Anak are both controlled by Chong, who holds 60% of both companies. This means that the actual consideration will be ignored and the disposal deemed to take place at the assets' residual expenditure (RE). As regards the agriculture assets, the AA of 50% for the year of assessment (YA) 2014 and YA 2015 claimed by Anak means these assets would have been written down to nil. Therefore, Bapak will not be able to claim any more AA in respect of these assets.

As regards the other business assets (plant, machinery and equipment), Anak (the transferor) will be entitled to claim CA until YA 2015, while Bapak (the transferee) will start claiming CA from YA 2016 onwards.

(c) Transfer of shares by Chong and Mano

Neither Anak nor Cucu hold any real property, so the transfer of their shares will not result in any charge to real property gains tax (RPGT).

Bapak both owns real property and is a controlled company, as it is wholly owned by two individuals. On 8 January 2013, when it acquired the 700 acres of land, it did not have any other tangible assets. Therefore the ratio of Bapak's real property to its total tangible assets was 100%, which is higher than the requisite minimum of 75%. Therefore, Bapak was a real property company (RPC) on 8 January 2013 and Chong and Mano were deemed to have acquired RPC shares on 8 January 2013.

As Chong and Mano are connected persons [para 23, Sch 2], and they are transferring a chargeable asset, namely RPC shares in Bapak, to NewCo, a company controlled by both of them, for a consideration entirely of shares in NewCo, the transaction is deemed to be at no-gain-no-loss [para 3(b), Sch 2]. There is therefore no RPGT exposure at this point in time.

(d) Inter-company payments after the rationalisation exercise

Bapak, Anak and Cucu will pay interest to NewCo for the treasury services.
Bapak and Anak will pay fees for shared services to Cucu.
Bapak will pay fees for logistics services to Anak.

All three payments will rank for tax deduction to the payer provided they are incurred for the purpose of their respective businesses.

However, care must be taken to ensure that the rates adopted for the payments are reasonable and approximate to market rates, such that these intra-group payments are comparable to those made between independent parties transacting at arm's length. If this is not the case, then the payments may not stand up to any transfer pricing scrutiny by the Director General of Inland Revenue.

(e) Group relief

If the corporate restructuring is completed as intended before 30 June 2016, then the four companies will become related companies in the basis period for the YA 2016 (as at least 70% of the paid up share capital of Bapak, Anak and Cucu will be held by NewCo). Therefore, the first YA that the group of companies is eligible for group relief will be YA 2018 because all of the following conditions are satisfied:

– All the companies are resident in Malaysia.
– The companies will be related companies throughout the basis period for the YA 2018 and the 12 months before it, i.e. in the basis period for the YA 2017.
– All the companies have a paid up ordinary share capital of RM3 million, i.e. more than the requisite minimum of RM2·5 million.
– All the companies make up accounts to a common year end date of 30 June.
– All four companies will be subject to tax at standard rates.
– None of the companies enjoy any tax incentives.

3 Esther

(a) Employee share option scheme (ESOS) taxable benefits

Exercise date of 30 December 2014

	RM
Market value of the shares at the date of exercise, i.e. 30 December 2014	2·20
Market value of the shares at the vesting date (exercisable date), i.e. 1 August 2014	2·00
Lower of the two (A)	2·00
Offer price (B)	1·80
No. of shares exercised (C)	10,000
Taxable benefit (A – B) x C	2,000

The taxable benefit will be taxed in the year of assessment (YA) 2014, i.e. the basis period for the YA when the ESOS is exercised.

Exercise date of 4 November 2015

	RM
Market value of the shares at the date of exercise, i.e. 4 November 2015	2·30
Market value of the shares at the vesting date (exercisable date), i.e. 1 August 2015	1·90
Lower of the two (A)	1·90
Offer price (B)	1·80
No. of shares exercised (C)	10,000
Taxable benefit (A – B) x C	1,000

The taxable benefit will be subject to tax in YA 2015.

(b) (i) Gains arising from the disposal of shares on 2 July 2015

The gains arising from the subsequent disposal of the shares after the exercise date is not regarded as the employment income of Esther and, therefore, should not affect her taxable employment income.

On the basis that Esther is not involved in share dealing activities, the gain arising from the disposal of the shares should be regarded as capital in nature and, therefore, not subject to income tax.

(ii) Dividends in cash and *in specie* received on 1 December 2015

Both the cash dividend and dividend *in specie* would be regarded as single tier dividends. Therefore, the dividend income received by Esther should be exempt from income tax [Paragraph 12B, Schedule 6].

(iii) Bank interest expense

On the basis that the bank loan on which the interest is payable was taken out to finance the acquisition of the shares, the interest expense should be attributed to the dividend income.

On the basis that the dividend income is a single tier dividend and, hence, exempt from income tax, the bank interest expense attributable to the dividends shall be disregarded for tax purposes [Paragraph 12B, Schedule 6].

(c) Deductibility of employee share expenditure to Intan Berhad (Intan)

(i) Issue of new shares

If Intan fulfilled its obligations under the employee share scheme using newly issued shares of its own, the share issue would merely involve a movement in the company's share capital account. As such, the company would not incur any actual costs which are wholly and exclusively incurred in the production of income. Therefore, no tax deduction would be allowed to Intan in respect of the issuance of the new shares to fulfil the company's obligations under the employee share scheme.

(ii) Transfer of treasury shares

In ascertaining the adjusted income of a company from a business source for the basis period for a year of assessment, a special deduction is allowable [under s.34D(1)] for any expenses incurred by that company in acquiring treasury shares.

As Intan transferred treasury shares to Esther to satisfy its obligations regarding the second tranche of shares, it will be able to claim a tax deduction for the cost of acquiring such treasury shares after deducting the amount paid by Esther, i.e. RM1,500 (RM19,500 (RM1·95 x 10,000) – RM18,000 (RM1·80 x 10,000)). In addition to the actual share cost, a deduction would also be allowed for the brokerage fees and interest cost incurred to finance the acquisition of the treasury shares used by Intan to fulfil its obligations under the ESOS. If Intan incurred any additional costs such as commission or stamp duty, these would also be deductible as part of the costs of acquiring the treasury shares.

Although the treasury shares were acquired in July 2014, the tax deduction will only be afforded to Intan in YA 2015, when Esther exercised her rights under the scheme, i.e. 4 November 2015.

[**Tutorial note:** *With effect from the year of assessment 2013, a new s.34D of the Income Tax Act, 1967 (the Act) was introduced to accord a special deduction on costs incurred in acquiring treasury shares by a company having a business source to fulfil its obligations under an employee share scheme. Prior to this, there was no specific provision in the Act to govern the tax deductibility of such expenditure. The Inland Revenue Board (IRB) has taken the position that employee share expenditure is not tax deductible under the general deduction test of s.33(1) of the Act.]*

4 David

(a) (i) Statutory rental income for the year of assessment (YA) 2014

	RM	RM
Rental income received in advance		96,000
Less:		
Renovation cost (not deductible: capital)	Nil	
Air conditioners (not deductible: capital)	Nil	
2014 quit rent and assessment (see note)	1,200	
Roof repair (revenue, deductible)	1,500	
Mortgage interest (see note)	18,000	
		(20,700)
Adjusted income		75,300
Less: Capital allowance on air conditioners (not available for non-business income)		Nil
Statutory rental income		75,300

Note: The full year's quit rent and assessment as well as the mortgage interest are allowable even though the property was not rented out from 1 January 2014 to 28 February 2014. Where the letting of a real property ceases temporarily due to the absence of tenants for a period of up to two years, the Inland Revenue Board (IRB) has taken the position that the expenses for the period the real property is not let out are allowable provided that the real property is maintained in good condition and is ready to be let out.

(ii) The expenses relating to the quit rent and assessment as well as the mortgage interest for the first two months in 2015 will be allowed as a tax deduction when the amounts are incurred, i.e. in YA 2015. In this particular case, as the rental income received in advance has already been assessed in the YA 2014, there would be no income available for set off against these rental expense deductions in YA 2015.

Where this is the case, any expenses incurred in relation to that rental income after the basis period in which the income is received are allowed as a deduction once incurred in the basis period in which the income is assessed. There would therefore be an amendment made retrospectively to the assessment for the YA 2014 when the expenses are subsequently incurred [Paragraph 9.2, Public Ruling 4/2011 – Income from Letting of Real Property].

(b) (i) Determination of the disposal and acquisition dates

Date of disposal
Where there is an agreement for the disposal of the property and the agreement is conditional, the disposal of the property is regarded as taking place at the time the agreement is made unless the disposal requires approval by the Government or a State Government or an authority or committee appointed by the Government or a State Government, in which case the date of disposal shall be the date of such approval [Paragraph 16, Schedule 2, RPGT Act 1976].

In the present case, as the sale and purchase agreement for the disposal of the property requires approval from the State Authority, the date of disposal will be 30 May 2015, being the date that approval from the State Authority was obtained.

Date of acquisition
As there was no agreement concluded for the acquisition of the bungalow, the date of acquisition is the date of completion of the disposal of the property. The date of completion of a disposal is the earlier of the following:

– the date on which the ownership of the asset disposed of is transferred by the disposer; or

– the date on which the whole of the amount or the value of the consideration for the transfer is received by the disposer [Paragraph 15, Schedule 2, RPGT Act 1976].

In this instance, as the full consideration was received on the earlier date of 15 August 2011, the date of acquisition is taken to be that date.

(ii) Real property gains tax (RPGT) for YA 2015

	RM	RM
Disposal price		
Consideration received (RM3,500,000 less furnishings of RM20,000)		3,480,000
Less: Renovation cost		(150,000)
Less: Legal fees		(30,000)
		3,300,000
Acquisition price		
Consideration paid	1,800,000	
Add: Incidental cost – stamp duty	48,000	
	1,848,000	
Less: Compensation received from neighbour	(10,000)	
Less: Forfeited deposit	(20,000)	
		(1,818,000)
		1,482,000
Less: Schedule 4 exemption		
Higher of RM10,000 and 10% of chargeable gain		(148,200)
Chargeable gain		1,333,800
RPGT rate		
Disposal date: 30 May 2015		
Acquisition date: 15 August 2011		
Disposal in the fourth year	20%	266,760

5 (a) Timah Sdn Bhd (Timah)

As Timah disagrees with the notices of additional assessment, Timah can submit an appeal within 30 days after the date of the notices of additional assessment. As the notices were both dated 30 November 2015, Timah is required to submit the appeal by 30 December 2015.

The appeal form to be used is a prescribed form [Form Q]. The appeal against an assessment must be in writing and should state the grounds of appeal. The grounds of appeal should be specific, referring to particular items in the tax computation or the notice of assessment with which the company disagrees.

The grounds for appeal which should be submitted are as follows:

Year of assessment (YA) 2009 – Time limitation to issue assessment
The notice of additional assessment for the YA 2009 is not valid. The Inland Revenue Board (IRB) only has five years, i.e. up to 31 December 2014, to issue an additional assessment in respect of YA 2009. In the absence of fraud, wilful default and negligence on the part of the company, the IRB was out of time to raise an additional assessment after 31 December 2014.

YA 2009 and YA 2010 – Disallowance of reinvestment allowance (RA) claims
The IRB has erroneously disallowed the RA claim for the YAs 2009 and 2010. The disallowance was made on the basis that the assets acquired in the relevant basis periods were not used for a qualifying project. However, Timah contends that these assets were, in fact, acquired for the purpose of expanding the manufacturing capacity of the company and, therefore, were used for a qualifying project. Copies of the production reports to demonstrate the increase in production capacity of the factory for the relevant YAs should be included to support the basis of the claim.

(b) Muthu

It is possible for Muthu to appeal against the estimated assessment raised within 30 days after the date of the notice of assessment. In submitting the appeal, Muthu would need to state the basis of the appeal. Given that his business is loss making, Muthu should provide the tax return and a tax computation for the YA 2014 to the IRB to demonstrate that the business was, in fact, loss making. Hence, there should be no tax liability for YA 2014.

If the IRB is satisfied with the tax computation provided, the IRB would then discharge the tax liability assessed together with the penalty.

[**Tutorial note:** *It should be noted that, in practice, the IRB has been known to maintain the penalty for late submission of a tax return even where there is a nil tax liability.*]

(c) Cekap Sdn Bhd (Cekap)

(i) For the YA 2015, Cekap has two sources of income, being interest income and trading business income. The date of commencement of operations for the interest and trading business sources would be 1 October 2014 and 1 February 2015 respectively.

(ii) As Cekap is not a small and medium enterprise, it is required to submit a tax estimate for its first basis period within three months from the date of the commencement of its operations. As the company commenced its first operation (relating to interest income) on 1 October 2014, it would be required to submit a tax estimate by 31 December 2014 via the prescribed form [Form CP 204]. Based on its projected interest income of RM120,000, the tax estimate to be submitted was RM30,000 (25% x RM120,000).

The company is required to pay the estimated tax liability by instalments commencing from the sixth month of the basis period. The number of instalments is determined based on the number of months in the first basis period. Cekap's first basis period is from 1 October 2014 to 30 September 2015, consisting of 12 months. Therefore, the tax instalment scheme would involve 12 instalment payments of RM2,500 per month (RM30,000/12 months) commencing from the month of March 2015 to February 2016. The monthly instalment is due to be paid by the 15th day of each month.

Under the tax law, a company can revise the tax estimates in the sixth and/or ninth month of the basis period (or both) via the prescribed form [Form CP 204A], i.e. in March 2015 and June 2015.

By March 2015, Cekap has commenced its trading business and has an estimated tax liability of RM1·2 million. Cekap should increase its tax estimate from RM30,000 to RM1·2 million in the sixth month. The difference between the two figures exceeds 30%. If the estimate is not revised, potentially there will be a penalty of 10% of the excessive difference. If the revised tax estimate is submitted before 15 March 2015, the company would not yet have paid any tax instalments for YA 2015. Therefore, the monthly instalments can commence based on the revised tax estimate of RM1·2 million, i.e. RM100,000 per month.

Following the major contract secured in May 2015, the estimated tax liability has increased to RM1·5 million. Cekap can revise its tax estimate during the ninth month, i.e. June 2015, to RM1·5 million. If it does so, the tax instalments for the remaining months would have to be increased accordingly. However, in this case, the projected tax liability of RM1·5 million is within the 30% threshold allowed under the tax law before a penalty for under-estimation of tax is applicable. Thus, Cekap may decide not to revise its tax estimates in the ninth month as not doing so would help to improve the cash flow of the company as the balance of the tax liability would only be required to be paid on the due date for the submission of the tax return, i.e. on 30 April 2016.

			Marks
1	Going Places Sdn Bhd (GP)		
(i)	**Form and quantum of the financing costs**		
	Option 1		1
	Option 2		1
			2
(ii)	**Deductibility of expenses of raising finance**		
	Option 1		
	Incidental cost of additional loan, not deductible with reason		0·5 + 1
	Interest expense, deductible with reason		0·5 + 1
	Dividends, not deductible with reason		0·5 + 0·5
	Option 2		
	Incidental cost of increased authorised share capital, not deductible with reason		0·5 + 1
	Expenses in rights issue, not deductible with reason		0·5 + 1
	Dividend, not deductible with reason		0·5 + 1
	Cost of premature repayment, not deductible with reason		0·5 + 1
		Available	10
		Maximum	8
(iii)	**SME status and tax treatment**		
	Option 1		
	Why SME for both YAs		1 + 1
	CA treatment, reason		1 + 1
	Tax rate		0·5
	Option 2		
	SME for YA 2016, not for YA 2017		0·5 + 1
	CA		1 + 1
	Tax rate		0·5
		Available	8·5
		Maximum	7
(iv)	**Comparative calculations**		
	Narrative on Option 1 and Option 2		1 + 2
	Conclusion		1
	Computation (Appendix) Options 1 and 2:		
	– Chargeable income		1 + 1
	– Tax payable		0·5 + 0·5
	– Net profit after tax		1 + 1
	– Retained earnings after dividend		0·5 + 0·5
		Available	10
		Maximum	8
(v)	**Proposed dividend**		
	Proposed distribution		0·5
	Retained earnings available – brought forward and 2016		1·5
	Conclusion		0·5
		Available	2·5
		Maximum	2

	Marks
(vi) Individual shareholders	
Fixed deposit interest	1·5
Share dividend	1·5
Capital appreciation	1
Risk of investment	0·5
Available	4·5
Maximum	4
Professional marks	
Format and presentation of the report	1
Clarity, effectiveness of communication including logical flow	2
Appropriate use of appendix	1
	4
	35

2 Bapak, Anak, Cucu and NewCo

Marks

(a) Cessation, transfer and commencement of income streams

Lease rental income ceases		0·5
Transfer of rubber plantation:		
Anak plantation source ceases		0·5
Treatment of loss		1
Treatment of unabsorbed AA/CA		1
Bapak's enlarged plantation source		0·5
Can claim CA brought forward from old source		1
Alternative treatment if two separate sources		1
Transfer of book-keeping and accounting services:		
No new business source for Cucu		0·5
Treatment of Cucu losses/unabsorbed CA		1
Treasury service, interest income, non-business		0·5 + 1
	Available	8·5
	Maximum	7

(b) Transfer of rubber plantation to Bapak

Potential agriculture charge with reason		1
Potential BA/BC re P&M		0·5
Controlled sale provisions apply, with reason		1
Controlled sale mechanism		1
Effect: Agriculture assets		1
Effect: Other assets including identification of YAs		1 + 1
	Available	6·5
	Maximum	6

(c) Transfer of shares

Anak and Cucu no real property		0·5
Bapak is RPC, with reasons		1 + 1
Chong and Mano deemed acquired RPC shares, date		0·5 + 0·5
Dispose chargeable asset to company controlled for 100% shares		0·5 + 0·5 + 0·5
	Available	5
	Maximum	4

(d) Inter-company payments after corporate exercise

Identify the payments (3 x 0·5)		1·5
Tax deductible, with reason		0·5 + 0·5
Transfer pricing issue, arm's length principle		1 + 1
	Available	4·5
	Maximum	4

(e) Group relief

Became related companies in YA 2016		1
Eligible in YA 2018 with reason		1
Paid up share capital condition and how met		1
Other conditions met (6 x 0·5)		3
	Available	6
	Maximum	4
		25

				Marks
3	**(a)**	**Exercise date of 30 December 2014**		
		Comparing the market value of shares at date of exercise and vesting date		1·5
		Computing the taxable benefit based on (A – B) x C		1·5
		Timing of taxability with reason		0·5
		Exercise date of 4 November 2015		
		Comparing the market value of shares at date of exercise and vesting date		1
		Computing the taxable benefit based on (A – B) x C		1
		Timing of taxability		0·5
				6
	(b)	**(i)**	Gains arising from disposal of shares on 2 July 2015	
			– Gain on disposal of shares does not affect employment income	1
			– Capital nature of the gains	1
		(ii)	Dividend in cash and *in specie* on 1 December 2015	
			– Both single tier dividends	1
			– Exempt from tax	0·5
		(iii)	Bank interest expense	
			– Attributable to dividend income	1
			– No tax deduction allowed as single tier dividends exempt	1·5
				6
	(c)	Tax deduction for issue of new shares		
		– Issuance of new shares merely a movement on capital account		1
		– No costs incurred in the production of income		1
		– No tax deduction allowed		1
		Tax deduction for transfer of treasury shares		
		– Special deduction available		1
		– Basis of determining the cost of acquiring the treasury shares		2
		– Timing of tax deduction with reason		2
				8
				20

				Marks
4	(a)	(i)	Rental income on a received basis	1
			Deductibility of expenses (each 0·5 x 5)	2·5
			Explanation of deductibility of vacant period expenses	1
			Non-availability of capital allowance with reason	1
			Available	5·5
			Maximum	5
		(ii)	Can claim tax deduction when expense incurred	1
			Allowable in the year when rental income is assessed	1
			Need to amend tax return/assessment	1
				3
	(b)	(i)	Disposal date: basis and date	1·5 + 0·5
			Acquisition date: basis and date	1·5 + 0·5
				4
		(ii)	Determining the disposal price	
			– Determine disposal price (excluding furnishing)	1·5
			– Renovation cost	1
			– Legal fees	0·5
			Determining the acquisition price	
			– Consideration paid	0·5
			– Stamp duty	0·5
			– Compensation received from neighbour	1
			– Deposit forfeited	1
			Schedule 4 exemption	1
			RPGT rate (4th year of disposal)	1
				8
				20

			Marks
5	**(a)**	Timah Sdn Bhd	
		Deadline for submission of appeal for additional assessment	1
		Forms to be used	1
		Grounds of appeal has to be specific	1
		Time limitation for YA 2009	2
		Basis of appeal for disallowance of RA	2
			7
	(b)	Muthu	
		Is possible to appeal an estimated assessment	0·5
		Need to prepare a tax return and tax computation to support nil tax return	1·5
		Penalty for late submission should also be discharged	1
			3
	(c)	Cekap Sdn Bhd	
		(i) Commencement date for interest income	0·5
		Commencement date for trading income	0·5
			1
		(ii) Submission of tax estimates within three months	1
		Payment of instalments based on the number of months in the basis period	1
		Instalment period commencement/cessation	1
		Instalment amount	0·5
		Due date each month	0·5
		Revision of tax estimates in the 6th and/or 9th month	1
		Revision of tax estimate in the 6th month, including 30% threshold and 10% penalty	3
		Revision of tax estimate in the 9th month, including benefit of not doing so	2
		Available	10
		Maximum	9
			20

Examiner's report
P6 Advanced Taxation (MYS)
December 2015

General Comments
The examination is made up of Sections A and B: Section A with two compulsory questions while Section B consists of three questions, two of which must be answered. Question 1 carries 35 marks, Question 2 is worth 25 marks while Questions 3, 4 and 5 each carry 20 marks.

The vast majority of candidates attempted the required four questions. There was no evidence of time pressure.

Candidates responded well on questions 3 and 4. The question candidates found most challenging were questions 2 and 5.

Below are two observations made with regard to the performance of candidates in this session:

- There was a discernibly lower incidence of merely regurgitating general features of a given technical topic. There is an increase in candidates' applying theory to the given scenario, which is encouraging; and

- Candidates still do not consider the question requirements closely enough before they jump in to respond.

Specific Comments

Question One
This 35-mark question was based on a family-owned transport company contemplating whether to adopt debt financing or equity financing. Candidates were required to prepare a report to Going Places Sdn Bhd (GP) to advise on the relative tax treatment of each option and to consider the relative tax position of investing in bank deposits or shares.

Part (i) required the identification of the form and quantum of the finance cost under each option. While the form of income was well identified, the quantum was often left unanswered.

Part (ii) pertained to the tax deductibility of various expenses incidental to raising debt/equity finance; the cost of premature repayment of bank borrowings under each option; interest expense; and dividend pay-out. This was reasonably well answered. It was noted that some candidates did not know that a 7% dividend means 7% of the equity capital, not 7% of net profit.

Part (iii) called for an assessment of the impact of each option on the small and medium enterprise (SME) status of GP and the attendant tax advantages of being an SME. This part was well answered.

Part (iv) required an analysis based on the calculation of retained earnings under each option. This was again well answered. A number of candidates still overlooked the best practice of attaching an appendix for supporting computations and are reminded that Question 1 carries professional marks for the presentation of their answer..

Part (v) asked whether GP was in a position to pay out dividends at the promised 7% rate in each of the next three years. Surprisingly, many candidates struggled with this requirement as they did not focus on the cumulative retained earnings.

Part (vi) changed perspective and required candidates to consider the comparative tax position of an individual shareholder looking to either invest further in GP shares or place the money in bank deposits. Only a minority of candidates wrote about the relative, non-tax, risks of investing in shares and in bank deposits.

Generally, Question 1 was reasonably answered by the majority of candidates although there were areas for improvement (as noted above).

Question Two
This 25-mark question depicted a referral of clients from a legal firm who were seeking tax advice on a proposed corporate rationalisation plan. The areas of focus were identified as impact on income streams, carry forward of unabsorbed capital allowances and losses, intra-group transfer of assets, transfer of shares, and post-corporate exercise issues like intra-group payments and group relief.

While not delving into details, this question called on candidates to be circumspect and to be able to form a big-picture view of the rationalisation scheme. This in turn required a comprehensive understanding of fundamental tax principles, rather than rote learning, and applying them to the scenario.

Although there were some candidates who produced highly satisfactory answers, many candidates did not perform well on this question.

Question Three
This 20-mark question tested employee share option scheme (ESOS) from the perspective of the employee as well as the employer. This was well answered and was a popular choice among the candidates.

The calculation of the taxable benefit to the employee was well answered. However, a number of candidates did not answer as well when assessing the proceeds from the subsequent share disposal by the employee.

As for the deductibility to the employer, many candidates did not know that the net cost of treasury shares is deductible because of a specific provision in the Income Tax Act.

Candidates preparing for the P6 (MYS) exam are encouraged to read the technical article “Employee share schemes” published on the ACCA website at the link below:

http://www.accaglobal.com/uk/en/student/exam-support-resources/professional-exams-study-resources/p6/technical-articles/employee-share-schemes.html

Question Four
This 20-mark question had two parts.

Part (a) tested the detailed/advanced aspects of the taxation of rental income. The issues included rental received in advance, expenses incurred in the year of cessation of rental, deductibility of expenses during temporary cessation, capital and revenue expenses.

Part (b) dealt with the real property gains tax (RPGT) issues when the rental property was disposed of.

This question was generally well answered.

Question Five
This 20-mark question examined some aspects of tax administration.

Part (a) dealt with issues such as timely and valid appeal against an additional assessment and the statutory time bar. Candidates indicated that, beyond knowing about the 30-day period for an appeal, they did not adequately know what a valid appeal entailed

Part (b) concerned a case of non-submission of a tax return while part (c) called for the determination of the date of commencement of income sources and the duty to provide a tax estimate and revised estimates.

This question was not a popular choice amongst candidates. Those who did choose to answer it did not show a sound knowledge of the relevant issues.

Candidates are well advised not to neglect the area of administration in their tax studies as it is an important component of the syllabus.

Conclusion

In preparing for this paper, candidates must ensure that they fully understand the tax subject matter, and hone their skills in applying the technical rules learned. They must read the requirements carefully so that they understand what is required and answer the question.

Examiner's report
P6 Advanced Taxation (MYS)
March 2016

General Comments
The examination consisted of two sections. Section A is compulsory and is made up of Question 1 for 35 marks and Question 2 for 25 marks, while Section B contained three questions of 20 marks each, from which candidates had to answer two questions.

In order to pass this examination, candidates must obtain a comprehensive knowledge of tax principles and, more important, develop the ability to apply that knowledge to given scenarios. Candidates should understand the rationale for given tax provisions rather than mechanically learning by rote.

During the exam, candidates would do well to read the requirements closely and be clear as to what exactly is required, so that they can proceed to precisely answer what is being examined. Regurgitating whatever is recalled of the subject matter takes up valuable time and will earn few marks.

The examination is not based upon traditional textbook type questions but on commercial scenarios. The examination necessarily contains technical material but a good part of the examination is based around the application of the fundamental principles in taxation.

Specific Comment

Question One
This question required the candidates to prepare a letter accompanied by an appendix to a client laying out the relative tax impact of alternative options in commencing a new manufacturing activity. The options involve the undertaking of the new activity either in the same company or in a new company, and adopting different appropriate tax incentive measures. The relevant tax incentive measures were identified for the candidates.

Candidates were required to explain how each company qualified for the respective incentive measure. This was relatively well responded to. Part of the question involved the set-off of capital allowances and losses under each option and many candidates knew the rules of set-off and carry-forward but were unable to apply these fundamental principles correctly to the scenario at hand.

When asked about the impact on the tax estimate for the existing company or the need to provide a tax estimate for the new company, candidates were unable to precisely answer the requirement set and instead provided detail about other aspects (such as the 85% rule, the instalments scheme, moratorium for small companies, penalties etc) which were irrelevant in this context. Many candidates were able to provide a recommendation, but did not follow through with valid justifications.

Question Two
The context of this question was a successful business relocating from rented premises to its own enlarged premises with ancillary facilities. In fact, the question tested fairly basic tax principles: classification of income streams – whether business source, whether separate business source; deductibility of expenditure items – whether capital or revenue, whether incurred in the production of gross income; and capital expenditure – whether plant, industrial building or simply non-qualifying.

Some candidates performed well here but others did less so. Those that did less well did not identify the basic principles being tested. In answering this type of question, there is a range of possible points, which could be raised by candidates. Candidates were given due credit for any well-argued conclusions reasonably applied to the scenario given.

Question Three

Question 3 comprised two distinct parts. In part (a), candidates were required to discuss how two related companies operating in Labuan were to be taxed, and to explain the possibility of an election for alternative tax treatment. This is a technical area and required a precise response. Many candidates did satisfactorily here, but other candidates just wrote down what they knew without reference to the specifics of the requirement.

Part (b) of the question dealt with settlement on a minor but also involved the application of basic tax principles relating to a tax computation. This was relatively well answered.

Question Four

This question examined the relative tax treatment of two business structures/entities in a given context of two individuals, one a resident and the other a non-resident, coming together to carry out a business. The requirement specified the areas for analysis and comparison. It also asked candidates for a conclusion on the preferred structure and further asked for non-tax differences between the business structures.

Some of the areas identified for comparison were well attempted: such as the persons chargeable, the determination of the entity's tax residence, the applicable tax rates, and the non-tax differences. However, other areas were not as well answered: such as the tax treatment of distributions and the computation of the after-tax return to the individuals.

Question Five

This question was made up of three distinct parts. Part (a) dealt with real property gains tax (RPGT), with a focus on a certain relief available. Computation of RPGT was also tested but with a twist, which was not spotted by many candidates. Generally, this part was satisfactorily answered, but there was room for improvement.

Part (b) dealt with the invocation of the general anti-avoidance rule in relation to a given scenario. Some candidates did well here and presented cogent arguments.

Part (c) was concerned with ethics, requiring candidates to explain the concepts of "tax evasion" and "tax avoidance" and to advise on an appropriate response to a client's request. This part was also well done, indicating a good appreciation of the concepts and an ability to translate this understanding to the given scenario.

Professional Level – Options Module

Advanced Taxation (Malaysia)

March/June 2016 – Sample Questions

Paper P6 (MYS)

Time allowed

Reading and planning: 15 minutes
Writing: 3 hours

This question paper is divided into two sections:

Section A – BOTH questions are compulsory and MUST be attempted

Section B – TWO questions ONLY to be attempted

Tax rates and allowances are on pages 2–4

Do NOT open this question paper until instructed by the supervisor. During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.
This question paper must not be removed from the examination hall.

Think Ahead ACCA

The Association of Chartered Certified Accountants

SUPPLEMENTARY INSTRUCTIONS

1. You should assume that the tax rates and allowances shown below will continue to apply for the foreseeable future.
2. Calculations and workings should be made to the nearest RM.
3. All apportionments should be made to the nearest whole month.
4. All workings should be shown.

TAX RATES AND ALLOWANCES

The following tax rates, allowances and values are to be used in answering the questions.

Income tax rates

Resident individual
Chargeable income

	RM	RM	Rate %	Cumulative tax RM
First	5,000	(0 – 5,000)	0	0
Next	15,000	(5,001 – 20,000)	1	150
Next	15,000	(20,001 – 35,000)	5	900
Next	15,000	(35,001 – 50,000)	10	2,400
Next	20,000	(50,001 – 70,000)	16	5,600
Next	30,000	(70,001 – 100,000)	21	11,900
Next	150,000	(100,001 – 250,000)	24	47,900
Next	150,000	(250,001 – 400,000)	24·5	84,650
Exceeding	400,000		25	

Resident company

Paid-up ordinary share capital	First RM500,000	Excess over RM500,000
RM2,500,000 or less	20%	25%
More than RM2,500,000	25%	25%

Non-residents

Company	25%
Individual	25%

Labuan entity – income from a Labuan trading activity

All chargeable profits	3%

Trust body – resident or non-resident

All chargeable income	25%

Personal deductions

		RM
Self		9,000
Disabled self, additional		6,000
Medical expenses expended on parents	(maximum)	5,000
Medical expenses expended on self, spouse or child with serious disease, including up to RM500 for medical examination	(maximum)	6,000
Basic supporting equipment for disabled self, spouse, child or parent	(maximum)	6,000
Purchase of sports equipment	(maximum)	300
Study course fees for skills or qualifications	(maximum)	5,000
Expenses on books for personal use	(maximum)	1,000
Spouse relief		3,000
Disabled spouse, additional		3,500
Child – basic rate	(each)	1,000
Child – higher rate	(each)	6,000
Disabled child	(each)	6,000
Disabled child, additional	(each)	6,000
Life insurance premiums and contributions to approved funds	(maximum)	6,000
Private retirement scheme contributions, deferred annuity premiums	(maximum)	3,000
Medical and/or education insurance premiums for self, spouse or child	(maximum)	3,000
Purchase of a personal computer	(maximum)	3,000
Deposit for a child into the National Education Savings Scheme	(maximum)	6,000

Rebates

Chargeable income not exceeding RM35,000	**RM**
Individual – basic rate	400
Individual entitled to a deduction for a spouse or a former wife	800

Capital allowances

	Initial allowance (IA) Rate %	Annual allowance (AA) Rate %
Industrial buildings	10	3
Plant and machinery – general	20	14
Motor vehicles and heavy machinery	20	20
Office equipment, furniture and fittings	20	10
Agriculture allowance		
Buildings for the welfare of or as living accommodation for farm employees	nil	20
Other buildings used in the business	nil	10
All other qualifying agricultural expenditure	nil	50

Real property gains tax

Category of disposal	Companies Rate %	Individuals – Non-citizens and non-permanent residents Rate %	All others Rate %
Disposal within three years after the date of acquisition	30	30	30
Disposal in the fourth year after the date of acquisition	20	30	20
Disposal in the fifth year after the date of acquisition	15	30	15
Disposal in the sixth year after the date of acquisition or thereafter	5	5	0

Goods and services tax (GST)

Standard rate	6%

Stamp duty

Rates of duty under the First Schedule

Conveyance, assignment, transfer or absolute bill of sale

	Rate %
Sale of property	
For every RM100 or fractional part thereof:	
On the first RM100,000	1
On the next RM400,000	2
On the excess over RM500,000	3
Sale of company shares	
On every RM1,000 or fractional part thereof	0·3

Section A – BOTH questions are compulsory and MUST be attempted

1 You are a tax associate of Tax Firm. Last week, the tax manager of Tax Firm handed you the financial statements of Grand Sdn Bhd (GSB) for the year ended 30 April 2016. He wants you to examine the critical tax issues and prepare the company's income tax computation for the year of assessment (YA) 2016. You have also managed to identify some further information about the company from GSB's tax files and further enquiries of the client.

Extracts from the financial statements – year ended 30 April 2016

Statement of profit or loss

Year ended 30 April	2016	2015
	RM'000	RM'000
Domestic sales	15,050	43,500
Export sales	70,200	1,200
Total sales	85,250	44,700
Costs of manufacturing	(65,250)	(36,500)
Gross profit	20,000	8,200
Less: Expenses		
Operating expenses	11,000	4,000
Overseas promotional expenses	165	nil
Maintenance and repairs	80	nil
Depreciation	1,000	500
Finance cost – lease interest	25	nil
	12,270	4,500
Net profit before tax	7,730	3,700

Notes to the accounts

Paid up ordinary share capital
This remains at RM5 million. There has been no change during the year ended 30 April 2016. As before, 65% of the share capital is held by GSB's foreign parent company while 35% is owned by a Malaysian individual.

Principal activities
The company manufactures clinical supplies in its factory in Shah Alam, Malaysia.

Additions to non-current assets
The following assets (installed in GSB's factory) were acquired under a finance lease during the year ended 30 April 2016:

	RM'000
Machinery	2,000
Lift	1,200
Total cost (exclusive of lease interest)	3,200

Finance lease payments
20 quarterly payments will be made under the finance lease. The amounts paid in the year ended 30 April 2016 are as follows:

Recipient	Asset	Principal	Lease interest
		RM'000	RM'000
Non-resident leasing company	Machinery	100	15
Resident leasing companies	Lift	60	10

The lease interest of RM25,000 is as charged in the statement of profit or loss.

Further information obtained from GSB's tax files and further enquiries of the client in relation to the year ended 30 April 2016

- The export of clinical supplies has a value added component of 35%.
- Of the operating expenses of RM11 million, RM428,000 is not tax deductible.
- The overseas promotional expenses were all incurred in creating and increasing the demand for GSB's export products.
- The lease agreements do not give GSB any option to acquire or dispose of the assets during or upon expiry of the lease term. It has been established that the lease agreements do not have salient characteristics of a hire purchase transaction. The lift is built into the factory building owned by GSB.
- GSB made full payment to the non-resident leasing company as and when the quarterly lease rental became due.
- GSB has contracted with another non-resident company to carry out the routine maintenance and repair work on all its machinery and equipment. Full payment of the RM80,000 gross contract price was made to the non-resident company within the normal 30-day period.
- GSB is not aware of the withholding tax provisions and therefore has not deducted any tax before remitting the payments made to either of the non-residents.
- There is no residual expenditure brought forward from YA 2015.
- GSB has never enjoyed any form of tax incentive.

Instructing email sent by your manager

Please prepare a report for GSB which addresses the following critical issues relevant to the year ended 30 April 2016:

(i) Export incentives – Explain why GSB qualifies for the allowance for increased exports as well as for the double deduction for the promotion of exports. Also explain the mechanism of the incentive in the tax computation.

(ii) Lease payments – Explain the tax treatment of the payments made for the lift and machinery from the perspective of GSB (the lessee).

(iii) Explain the implications of the withholding tax provisions for the lease payments and the fee for the maintenance and repairs.

(iv) Explain the consequences of non-compliance with the withholding provisions and the action(s) which GSB can take to mitigate these tax consequences.

(v) Prepare a computation of the income tax payable by GSB for YA 2016, starting with the net profit before tax figure, on the assumption that the withholding tax provisions have been complied with and all available tax incentives are claimed.

Required:

Draft the report to Grand Sdn Bhd as instructed by your manager.

The following marks are available:

(i) Export incentives. (9 marks)

(ii) Lease payments. (7 marks)

(iii) Withholding tax provisions. (4 marks)

(iv) Consequences of non-compliance and their mitigation. (6 marks)

(v) Income tax computation for YA 2016. (5 marks)

Professional marks will be awarded in question 1 for the appropriateness of the format and presentation of the report and the effectiveness with which the information is communicated. (4 marks)

(35 marks)

2 Yesterday, Mr Bijak (Bijak), a Malaysian citizen, came to the office of Tax Firm to seek tax advice. Your tax director and you, his tax assistant, met with him.

An extract from the notes of your meeting and your tax director's instructions to you following the meeting are set out below:

Extracts from the notes of the meeting

Bijak is a research scientist with four scientific patents registered in his name. He receives royalties of about RM50,000 each year. He also operates a thriving consulting practice as a sole proprietor.

As part of his estate planning, Bijak intends to transfer his patents and the consulting business to a private limited company.

Mr Bijak's friend, Mr A, has offered to sell his dormant company (A Sdn Bhd) to Bijak. The shares in A Sdn Bhd are currently held 50% by Mr A and 50% by his wife, Mrs A.

The dormant company previously traded as a technology company and has unabsorbed losses of RM200,000 and capital allowance amounting to RM100,000.

On acquiring the dormant company, Bijak and his wife, Mrs Bijak, will hold the shares in the ratio of 70:30. The name of the company will be changed to Bijak Sdn Bhd (BSB).

Bijak will thereafter transfer the business premises and office equipment of his sole proprietor business together with the four patents to BSB in return for more shares in BSB to be held by himself and his wife (still in the ratio 70:30). The business premises were purchased by Bijak for RM150,000 in February 2010 and are anticipated to have a market value of RM750,000 when transferred to BSB. The office equipment has a market value of RM70,000.

Your tax director's instructions

In respect of the proposed takeover of the dormant company by Bijak, please carry out the following work in preparation for our follow-up meeting:

(a) Explain the tax implications for both Bijak and BSB of the transfer of the tangible and intangible assets by Bijak to BSB. Specifically:

- **(i)** The real property gains tax treatment of the transfer of the business premises by Bijak to BSB, together with an explanation on why this may be tax disadvantageous and any advice to make this transfer more tax efficient.
- **(ii)** The income tax treatment of the transfer of the office equipment.
- **(iii)** The income tax implications of the transfer of the four patents. You should consider the capital versus revenue issue in respect of the disposal and the treatment of the royalty income both before and after the transfer of the patents.

(b) Advise on the utilisation of the brought forward business losses of RM200,000 and capital allowance of RM100,000.

Required:

Carry out the work as instructed by your tax director.

The following marks are available:

(a) Transfer of assets:

- **(i) Business premises;** (9 marks)
- **(ii) Office equipment;** (5 marks)
- **(iii) Patents.** (7 marks)

(b) Unabsorbed business losses and capital allowance. (4 marks)

(25 marks)

Section B – TWO questions ONLY to be attempted

3 **(a)** Raya Sdn Bhd (Raya) has two wholly owned subsidiaries: Mawar Sdn Bhd (Mawar) and Orkid Sdn Bhd (Orkid).

	Business activities
Raya	Provision of management services
Mawar	Provision of advertising services
Orkid	Provision of printing services and the rental of apartments

The companies are planning to enter into the following transactions in the near future:

– The provision of management services by Raya to Mawar and Orkid.

– The provision of local advertising services by Mawar to Orkid at a 20% discount.

– The provision of local advertising services free of charge by Mawar to an unconnected private school.

– The disposal of a printing machine by Orkid to an overseas customer, who has requested that the machine is delivered to its subsidiary company in Penang, Malaysia.

To simplify the three companies' goods and services tax (GST) compliance, the group applied for a group registration. The Royal Malaysian Custom Department (RMC) rejected the group registration application for all three companies, and has only allowed Raya and Mawar to be included in a group for GST purposes.

Required:

(i) Explain the basis for the Royal Malaysian Custom Department's (RMC) rejection of the application for group registration and the exclusion of Orkid Sdn Bhd from the group registration. (3 marks)

(ii) State, with reasons, the goods and services tax (GST) treatment of each of the four proposed transactions listed above, assuming that these take place following the group registration of Raya Sdn Bhd and Mawar Sdn Bhd. (8 marks)

(b) You are a tax manager with Tax Firm. Fitri Sdn Bhd (Fitri), a client company which manufactures mobile phones, was audited by the Inland Revenue Board (IRB) on 28 March 2016. The tax audit covered the year of assessment (YA) 2013 and YA 2014. During the tax audit, the IRB made the following findings:

– Fitri had claimed industrial building allowance (IBA) in respect of an office block constructed and put into use in YA 2009. The IRB disallowed the IBA claim for YA 2009 to YA 2014 inclusive. Notwithstanding the disallowance, there was no additional assessment for the relevant YAs because there were unutilised tax losses. The tax losses available for carry forward to YA 2015 were reduced by RM1,500,000.

– Fitri had treated the interest income from overdue accounts from customers for YA 2014 as part of its manufacturing business income. The IRB assessed the interest income as a separate source. As a result, the IRB raised an additional tax assessment of RM100,000 and imposed a penalty of RM45,000.

The directors of Fitri have asked you to arrange a meeting with the IRB to negotiate a lower penalty. To facilitate the negotiation, the directors have given you two mobile phones and have insisted that you present these as gifts to the IRB officers.

Required:

(i) Advise Fitri Sdn Bhd (Fitri) whether the Inland Revenue Board (IRB) can disallow the industrial building allowance claim made by the company for the years of assessment 2009 to 2014. (3 marks)

(ii) Explain the basis for the IRB's treatment of the interest income and advise Fitri whether the IRB is correct in raising the additional assessment, including the penalty. (3 marks)

(iii) Explain the course of action you should take in relation to the mobile phones given to you by the directors of Fitri. (3 marks)

(20 marks)

4 (a) Gembira Trust Fund (the Fund) is a unit trust fund set up to invest in shares, securities and bonds. For the financial year ended 30 September 2015, the statement of profit or loss of the Fund was as follows:

	RM	RM
Dividend income from shares listed on the Bursa Malaysia		800,000
Dividend income from a Singapore investment		200,000
Interest from convertible loan stock		500,000
Interest from government bonds		300,000
Gains from the disposal of shares		700,000
		2,500,000
Less: Expenses		
Manager's remuneration	200,000	
Audit and accounting fees	50,000	
Stationery and printing	20,000	
Trustees' fees	30,000	
		(300,000)
Profit for the year		2,200,000

Cantik Sdn Bhd (Cantik), a Malaysian tax resident company, holds 10,000 units of the Fund. On 1 March 2016, Cantik received a net distribution of RM100,000 from the Fund comprised as follows:

	RM
Taxable income	40,000
Malaysian tax paid	(10,000)
	30,000
Non-taxable income	70,000
	100,000

Required:

(i) Compute the chargeable income of Gembira Trust Fund for the year of assessment 2015. (6 marks)

(ii) Explain how Cantik Sdn Bhd will be taxed in relation to the distribution received from Gembira Trust Fund for the year of assessment 2016. (3 marks)

(b) Encik Ali and Encik Baba operated a partnership (the partnership) which provided engineering services. The terms of the partnership were as follows:

	Ali	Baba
Profit sharing ratio	50%	50%
Partners' salaries	RM50,000	RM80,000

On 1 January 2015, the partnership was converted into a limited liability partnership (LLP). The LLP has the same profit sharing ratio and partners' salaries as the partnership. The LLP has continued to provide engineering services.

The partnership's office equipment and furnishings were transferred to the LLP on 1 January 2015. The original cost and the residual value of these assets were RM2,500,000 and RM1,500,000 respectively. The applicable annual allowance rate for these assets is 10%.

The partnership has an unabsorbed tax loss brought forward from the year of assessment 2014 amounting to RM300,000.

The statement of profit or loss of the LLP for the financial year ended 31 December 2015 is as follows:

	RM'000	RM'000
Revenue from engineering services		6,000
Interest income on a loan to a third party		500
Less: Expenses		
Partners' salaries (per LLP agreement)	130	
Holiday trip for Ali	20	
Depreciation	100	
Entertainment of existing customers	100	
Other deductible expenses	4,500	
		(4,850)
Profit before tax		1,650

The LLP did not incur any additional capital expenditure qualifying for capital allowance for the year of assessment 2015.

Required:

(i) With reference to the scenario above, explain the difference in the tax treatment of the following items in the LLP as compared to the partnership:

- **interest income;**
- **partners' salaries; and**
- **distribution of profits.** (6 marks)

(ii) Compute the chargeable income of the LLP for the year of assessment 2015. (5 marks)

(20 marks)

5 **(a)** Harold, a Malaysian citizen, died on 15 July 2013, leaving behind a widow, Jill, and a son, James. Under the terms of Harold's will, his brother was appointed the executor of the deceased estate.

The following assets were disposed or transferred by the executor on 1 October 2015:

Asset	Location	Market value on 15 July 2013 RM'000	Market value on 1 October 2015 RM'000
Shop house	Penang, Malaysia	800	1,000
Apartment	Ipoh, Malaysia	300	400
Bungalow	Kuala Lumpur, Malaysia	2,000	2,400
Condominium	Singapore	1,500	1,600

The executor sold the shop house to realise cash to settle Harold's debts.

Instead of the cash legacy of RM350,000 left to James under the terms of Harold's will, the executor transferred the apartment to James.

The bungalow and condominium were transferred to Jill in accordance with the terms of Harold's will.

Required:

Explain the real property gains tax treatment in relation to the following:

(i) Devolution (transfer) of the assets of the late Harold on the executor of the deceased estate. (2 marks)

(ii) Disposal of the shop house by the executor. (3 marks)

(iii) The basis for determining James's acquisition price and acquisition date in respect of the apartment transferred to him. (3 marks)

(iv) The basis for determining Jill's acquisition price and acquisition date in relation to the bungalow and condominium transferred to her. (4 marks)

(b) Ten officers from the Inland Revenue Board (IRB) visited the office of Magnolia Sdn Bhd (Magnolia) this morning without any prior notice. On arrival, they informed Magnolia's finance director, Rahmat, that the company is under tax investigation.

As you are the tax adviser of Magnolia, Rahmat contacted you immediately. As he and his finance team are busy preparing for a corporate transaction, Rahmat is wondering whether it is possible to ask the IRB officers to come back at a later date.

Required:

Explain the difference between a tax audit and a tax investigation in terms of purpose and prior notice and whether it is possible for Magnolia Sdn Bhd to request the Inland Revenue Board (IRB) to defer the investigation procedure. (4 marks)

(c) BungaRaya Sdn Bhd (BungaRaya) is a resident company which makes up its accounts annually to 30 November. You have been appointed as the tax agent for the company effective from the year of assessment 2015.

As three key finance personnel resigned last month, BungaRaya does not expect its audited accounts for the financial year ended 30 November 2015 to be finalised and signed by 30 June 2016.

As the deadline for the tax return submission is approaching, the company has informed you that it plans to submit the annual tax return for the year of assessment 2015 even though the audited accounts will not be signed by the tax submission deadline.

Required:

Explain the consequences for BungaRaya Sdn Bhd of filing its annual tax return for the year of assessment 2015 without the signed audited accounts and the action the company can take to avoid such consequences.
(4 marks)

(20 marks)

End of Question Paper

1 Report to Grand Sdn Bhd

From Tax Firm
To Chief Accountant, Grand Sdn Bhd
Date 9 June 2016

Report on the tax issues for the year of assessment 2016

Below are details of the critical tax issues for Grand Sdn Bhd (GSB) for the year of assessment (YA) 2016.

(i) Export incentives

GSB is eligible for two export incentives: the allowance for increased exports and the double deduction for the expenses relating to the promotion of exports.

Allowance for increased exports (AIE)
GSB is eligible for the AIE because it fulfills the following conditions:

– It is a resident company engaged in manufacturing and exporting a manufactured product, i.e. clinical supplies.
– The exported product, i.e. clinical supplies, is not on the excluded list which mainly comprises primary products.
– It did not enjoy any incentives under the Promotion of Investments Act 1986 (other than the double deduction for the promotion of exports) and the reinvestment allowance.
– It has attained an increase in export sales in YA 2016 when compared to YA 2015.
– The clinical supplies exported have a value added component of 35%, which is more than the requisite 30% of value added.

The rate of AIE which GSB is eligible for is therefore 10% of the value of its increased export sales.

The increase in the value of GSB's export sales is RM69 million (RM70,200,000 – RM1,200,000), and the AIE for YA 2016 is therefore RM6·9 million (10% of RM69 million).

Tutorial note: *GSB is 65% foreign-owned. Therefore, despite registering a significant increase in exports (at least 50%), GSB does not qualify for the enhanced export incentive pursuant to PU(A) order 158 of 200 as the said incentive is available only to local companies (at least 60% Malaysian-owned).*

The AIE can be set off against 70% of the statutory income for a year of assessment. Any amount unabsorbed may be carried forward to be similarly set off against the statutory income of future years.

Please refer to the tax computation in the Appendix for the impact of this incentive in YA 2016.

Promotion of exports
As the overseas promotional expenses were incurred to create and increase the export demand for GSB's product, the company is eligible for a double deduction under the promotion of export incentive.

Hence the expense of RM165,000 may be deducted a second time in arriving at the adjusted income for YA 2016.

The two export incentives are not mutually exclusive and thus both may be claimed.

Please refer to the tax computation in the Appendix for the impact of this incentive in YA 2016.

(ii) Lease payments

Notwithstanding the accounting treatment of the assets acquired under a finance lease, the tax treatment is such that lease payments made under finance lease arrangements are treated no differently from payments made under an operating lease, unless the lease arrangement is a deemed sale pursuant to the tax law [the Income Tax Leasing Regulations 1986, as amended].

With reference to the machinery, as the lease agreement does not feature any right for the lessee to acquire the leased assets during or at the end of the lease term, there is no reason to assume a deemed sale in respect of the machinery. Therefore, the machinery may be accorded the lease treatment in that the lease payment made of RM115,000 (RM100,000 + RM15,000) is fully tax deductible as an expense [under s.33(1)].

As RM15,000 has already been charged to the statement of profit or loss, a tax adjustment should be made to deduct the additional RM100,000.

As regards the lift, the nature of the asset is such that it is incorporated as part of the building so that the asset is not amenable to being moved and being used by another user without making substantial alterations. The lift is therefore a special-purpose asset which by the tax law [the Income Tax Leasing Regulations 1986] is compulsorily deemed to be the subject of a sale rather than a leased asset. Therefore, GSB is deemed to have acquired the lift and is therefore entitled to claim capital allowances in respect of the cost of the lift, as well as a revenue deduction for the lease interest.

The lift should be properly treated as plant and machinery used in the business, therefore qualifying for a capital allowance of the 14% annual rate and the initial allowance rate of 20%. As the lease agreements do not have the salient characteristics of a hire purchase transaction, the deemed sale of the lift is treated as an outright purchase.

Please refer to the tax computation in the Appendix for the impact of this incentive in YA 2016.

(iii) Withholding tax provisions

The lease payment for the machinery made to a non-resident company is considered to be rent paid for the use of movable property [s.4A(iii)]. The lease payment is, therefore, deemed derived in Malaysia as the payer (GSB) is a resident of Malaysia.

The withholding tax provisions [s.109B] require GSB, as the payer, to withhold tax of 10% when paying the non-resident.

Similarly, the payment to the non-resident for the maintenance and repair of the machinery and equipment is classed as a technical fee [under s.4A(ii)] and is also deemed derived from Malaysia as the payer (GSB) is a resident of Malaysia.

Again, the withholding tax provisions require GSB, as the payer, to withhold tax of 10% when paying the non-resident.

Tutorial note: *The withholding tax provisions do not apply to the lease payments for the lift as these are made to a resident company.*

(iv) Non-compliance with withholding tax provisions – consequences and mitigation

GSB has failed to withhold the 10% tax upon paying the amounts to the non-resident recipient and has not accounted for the tax to the Director General of Inland Revenue (DGIR) within one month after the time of payment.

The consequences of such non-compliance are:

– GSB will have to bear the 10% withholding tax as the payments made to the non-residents will be deemed to have been made net of withholding tax. This withholding tax will amount to RM21,667 [(RM115,000 + RM80,000)/90 x 10%)].

  Alternatively, if GSB pays the withholding tax of RM19,500 (being 10% of RM195,000 (RM115,000 + RM80,000)) to the DGIR, under the relevant tax law, GSB is then permitted to recover the withholding tax of RM19,500 from the non-resident recipients as tax paid on their behalf.

– GSB will also suffer a 10% penalty for late payment and this amounts to RM2,167 (RM21,667 x 10%) or RM1,950 (RM19,500 x 10%).

– The payments made of RM195,000 will be disallowed for tax purposes [under s.39] because the withholding tax provisions have not been complied with.

To mitigate the consequences, GSB should settle the withholding tax and the 10% late payment penalty by the due date for the annual submission of its tax return. The due date for GSB's tax return for YA 2016 will be 30 November 2016, i.e. seven months after the close of its accounts on 30 April 2016.

If this is done, then the lease payment of RM115,000 and the maintenance and repair expense of RM80,000 will rank for deduction in arriving at the adjusted income of GSB for YA 2016. However, the withholding tax of RM21,667 and the penalty of RM2,167 (or RM1,950) will not be tax deductible, according to the Inland Revenue Board's current practices.

Tutorial note: *If GSB does not pay the withholding tax and penalty and instead files its tax return with a deduction for the expenses subject to withholding tax, the DGIR may also impose a penalty for an incorrect return [under s.113].*

Marking note: *Full credit may be awarded to candidates exploring either of the alternatives outlined above (being RM21,667 withholding tax or RM19,500 withholding tax) – i.e. both answers did not require to be presented.*

(v) Income tax computation for YA 2016

Attached herewith is the tax computation for YA 2016, based on the assumption that all the withholding tax provisions have been complied with.

After the additional deductions for the promotion of exports and lease payments, the adjusted income is RM8·893 million.

The AIE absorbed is RM5·94 million, and this amount will be credited to a tax exempt account available for distribution to GSB's shareholders as an exempt dividend.

– End of report –

Appendix: Income tax computation for YA 2016

		RM'000	RM'000
Net profit before tax			7,730
Add:	Non-deductible operating expenses	428	
	Depreciation	1,000	
			1,428
			9,158
Deduct:	Double deduction: promotion of exports	165	
	Lease rental for machinery	100	(265)
Adjusted income			8,893
Less:	Capital allowance on lift:		
	RM1,200,000 x (20% + 14%)		(408)
			8,485
70% thereof		5,940	
Allowance for increased exports (AIE):			
RM69,000,000 x 10%		6,900	
Less: Absorbed		(5,940)	(5,940)
Unabsorbed AIE carried forward		960	
Amount credited to exempt account		5,940	
Statutory/aggregate/total/chargeable income			2,545

Tax charged at 25%: RM636,250

2 Bijak and Bijak Sdn Bhd (BSB)

(a) Transfer of assets

(i) Business premises

The transfer of the business premises will be a disposal of real property subject to the real property gains tax (RPGT) provisions.

As Bijak will hold 70% of the shares of BSB, he will have control of the acquirer company. The consideration is also wholly in shares and, therefore, the disposal will fall into the category of a transfer of an asset owned by an individual to a company controlled by him for a consideration consisting entirely of shares. Under this category [paragraph 3(b) of Schedule 2], the transaction is deemed to be a disposal at the original acquisition price, i.e. at no-gain-no-loss.

BSB will be deemed to have acquired the premises at the date of transfer but at the original acquisition price of RM150,000 paid by Bijak in February 2010. If BSB were to dispose of the business premises subsequently, the holding period would be counted from the date of transfer.

The shares acquired by Bijak as consideration for the transfer of the business premises will constitute a chargeable asset, and will be subject to RPGT [under paragraph 34] when the shares are subsequently disposed of. Bijak's acquisition price is equal to RM150,000 being the original acquisition price of the real property subject to the no-gain-no-loss transfer. This is clearly disadvantageous to Bijak and BSB.

However, if Bijak were to dispose of the business premises for a consideration other than substantially in shares, the disposal would be subjected to the normal RPGT rules. As such, the transaction would be subject to RPGT at a rate of 0% as Bijak is a citizen and has held the real property for more than six years. If this were the case, BSB would have the current market price of the business premises of RM750,000 as its acquisition price, rather than the acquisition price in February 2010 of RM150,000.

Therefore, it is advisable for Bijak to dispose of the business premises to BSB at the prevailing market price for cash or for cash and shares (the shares not exceeding 75% of the total transaction price). BSB could obtain a loan for the acquisition of the business premises. The interest expense on the loan should reasonably be tax deductible against its business source income as it is assumed that the business premises would be used for the purposes of its business.

(ii) Office equipment

The disposal of office equipment by Bijak, a sole proprietor, to BSB, a company controlled by him, will be a controlled transfer. By operation of the controlled transfer rules, the transaction price is deemed to be the residual expenditure of Bijak as sole proprietor, with the result that no balancing charge or balancing allowance will apply.

BSB will continue to claim annual allowances on the office equipment, but not an initial allowance, based on the original cost of the asset to Bijak but restricted to the residual expenditure of Bijak. In the event of a future disposal of the equipment by BSB resulting in a balancing charge, the balancing charge will be restricted to the total capital allowances claimed by both Bijak and BSB.

(iii) Patents

Patents are intangible assets and do not constitute plant. Therefore, the transfer of the four patents will not have any capital allowance implications.

The disposal price attributable to the four patents could be argued to be capital in nature as they produce royalty income for Bijak and there are only four. Alternatively, the argument that the disposal proceeds are revenue in nature finds support in the definition of a royalty [in s.2] which includes 'income from the alienation of 'patents''. However, on balance, the disposal proceeds are more likely to be treated as capital in nature, and therefore not subject to income tax.

Before the transfer of the patents, Bijak is the recipient of the royalties. This is royalty income to Bijak [under s.4(d)]. The current exemptions for royalties do not extend to royalties arising from scientific patents. Hence Bijak is fully taxable on the RM50,000 royalties.

Once the patents are transferred to BSB, Bijak will cease to be the recipient and BSB will become the rightful recipient of the royalties. BSB will also be subject to tax in respect of the entire annual sum of RM50,000.

(b) Unabsorbed losses and capital allowance (CA)

When Bijak and his wife take over the dormant company, they will together acquire 100% of the shares. Thus, there will have been a 100% change in shareholders, i.e. greater than 50%. Therefore, as the company is currently a dormant company, the RM200,000 unabsorbed loss cannot be carried forward following the substantial change in ownership and will be lost. The CA of RM100,000 will also be lost, not only for this reason but because, as the company is dormant, its earlier business has presumably ceased.

Tutorial note: *If there are good reasons for the substantial change in the share ownership of a company, an application may be made to the Minister of Finance for approval to carry forward the unabsorbed losses and CA.*

3 (a) Raya Sdn Bhd group

(i) Group registration for goods and services tax (GST)

One of the conditions for a group company to be eligible for the GST grouping provision is that the company must be providing wholly taxable supplies. In the case of Orkid Sdn Bhd (Orkid), the company is involved in the provision of printing services and the rental of apartments. As the rental of apartments is regarded as an exempt supply for GST purposes, Orkid is a mixed supplier (i.e. regarded as providing both taxable and exempt supplies). Therefore, Orkid will be disqualified from group registration.

(ii) GST treatment of transactions

– **Provision of management services by Raya Sdn Bhd (Raya) to Mawar Sdn Bhd (Mawar) and Orkid**
  Raya and Mawar are approved for group registration. Therefore, any supplies between Raya and Mawar would be disregarded for GST purposes and there is no requirement for Raya to charge GST on the management service fees charged to Mawar. However, as Orkid is not a group participant, the provision of management services by Raya to Orkid would be subject to GST at the standard rate of 6%.

– **Provision of local advertising services by Mawar to Orkid at a 20% discount**
  The provision of local advertising services is a taxable supply subject to GST at 6% [under Paragraph 1(2), Schedule 3, GST Act 2014]. Where the taxable person making the supply is connected with the person to whom the supply is made, and:

  – the value of the supply made by the taxable person for a consideration is less than its open market value; and
  – the supply is a taxable supply and the person to whom the supply is made is not entitled to an input tax credit for the whole or any part of the tax on the supply

  the value of the taxable supply of goods and services shall be taken to be its open market value.

  In the present case, as Orkid is a mixed supplier and therefore is not entitled to fully claim the input tax credit, so the GST on the provision of local advertising services by Mawar should be accounted for based on the open market value of the services instead of the discounted price.

– **Provision of local advertising services free of charge by Mawar to an unconnected private school**
  The general rule under the GST Act is that a supply of services made without consideration is not a supply unless it is made to a connected person. As Mawar is not related to the private school, the provision of the local advertising services without consideration should not be subject to GST.

– **Disposal of a printing machine to an overseas customer**
  The printing machine is a capital asset to Orkid but as the GST legislation does not distinguish between revenue or capital assets, the disposal of the printing machine constitutes a supply subject to GST.

  The disposal of the machine can qualify to be zero rated if the machine is exported or sent out from the country. In this particular case, even though the customer is overseas, the customer has requested that the machine be sent to its subsidiary company in Penang. Therefore, the disposal of the printing machine cannot qualify to be zero rated and is properly subject to GST at 6%.

(b) Fitri Sdn Bhd (Fitri)

(i) Disallowance of industrial building allowance

The Inland Revenue Board (IRB) has made the necessary adjustments in respect of the industrial building allowance (IBA) wrongly claimed in respect of an office building by Fitri from the year in which the office building was put into use, i.e. from YA 2009.

Based on the tax legislation, the Director General of Inland Revenue (DGIR) can make an assessment or additional assessment, in respect of a person within five years from its expiration. However, the five-year time limitation does not apply to situations involving fraud, wilful default and negligence made by the taxpayer.

Furthermore, under the IRB Tax Audit Framework, it is provided that a tax audit may be extended to cover a period up to five YAs pursuant to issues uncovered during the audit. Similarly, this time limit is not applicable to cases involving fraud and tax evasion.

On the basis that Fitri has been negligent in claiming IBA on the office building, it is possible for the DGIR to make tax adjustments from YA 2009 onwards. Moreover, the tax adjustment made did not result in an additional tax liability and merely reduced the unabsorbed tax losses. It should be noted that the five-year time limitation provided in the tax legislation refers to the issuance of assessments and additional assessments. Since no assessment or additional assessment is involved, the time limitation should not apply.

Therefore, the IRB is permitted to disallow Fitri's IBA claim.

(ii) Tax treatment of interest income

With effect from the YA 2014, it is provided that all interest income (other than interest which relates to a debenture, mortgage or other source which forms part of the stock in trade of a business or interest in respect of a loan granted in the course of carrying on a business of money lending) should be assessed separately as a source of non-business income. In this respect, notwithstanding that the interest arose from overdue accounts from customers, the amount should be deemed as non-business income.

As non-business income, the interest income cannot be sheltered by the available unabsorbed tax losses. Therefore, the company will have chargeable income for YA 2014 and it is correct for the IRB to raise the additional assessment for that year.

Based on the Tax Audit Framework, if following an audit it is discovered that there has been an understatement of income, the DGIR can impose a penalty for the understatement of income [under s.113(2)] equal to the amount of tax undercharged (i.e. 100% penalty). In this case, the DGIR, in exercising its discretionary powers, has imposed a lower penalty of 45% of the tax undercharged. Therefore, the imposition of the penalty of 45% is in line with the provisions of the Tax Audit Framework.

(iii) Gifts for the IRB officers

The two mobile phones should be returned to the directors of Fitri with the emphatic message that it is prohibited for a taxpayer to make any form of gift to an audit officer and/or transact any business with an audit officer during the audit process. Under the law, IRB officers are prohibited from accepting any gift from any party.

If the directors persist as regards the gifts, they should be informed that we will no longer be in the position to act on behalf of Fitri and will have to resign as the company's tax adviser.

4 (a) (i) Gembira Trust Fund

Chargeable income for the year of assessment 2015

	RM	RM
Dividend income from shares listed on the Bursa Malaysia		Nil
Dividend income from a Singapore investment		Nil
Interest from convertible loan stock		500,000
Interest from government bonds		Nil
Gains from the disposal of shares		Nil
Gross income		500,000
Less: Special deduction for unit trust		
A x B/4C (see working)	13,500	
OR		
10% of RM270,000 (A)	27,000	
Whichever is greater		(27,000)
Chargeable income		473,000

Working:

	RM
Total permitted expenses (A):	
Manager's remuneration	200,000
Audit and accounting fees	50,000
Stationery and printing	20,000
Trustees' fees	Nil
	270,000
Gross income (B)	500,000
Aggregate of gross income (whether chargeable or not) (C)	2,500,000

A x B/4C: 270,000 x 500,000/(4 x 2,500,000) = RM13,500

(ii) Cantik Sdn Bhd (Cantik)

Any distribution received from a unit trust which is paid out of exempt income is not liable to tax. Therefore, of the distribution of RM100,000 received from Gembira Trust Fund, only RM40,000 would be taxable on Cantik. As tax has been paid by Gembira Trust Fund, Cantik will be able to claim a tax credit of RM10,000 against its own tax liability on the distribution.

(b) (i) Differences in tax treatment – partnership v LLP

Interest income
A partnership is not a taxable entity and the income of the partnership is taxed at the respective partners' level. The share of the interest income for each partner is aggregated with the partners' other interest income and taxed in the hands of the partner.

On the other hand, an LLP is a taxable entity. So, the interest income on the loan to a third party will be taxed at the LLP level and no interest income from the LLP should be declared or taxed on Ali or Baba.

Partners' salaries
The salary paid to a partner is aggregated together with their share of divisible income and constitutes the adjusted income of the partner from the partnership business.

Under the LLP structure, the partners' salaries of RM130,000, to the extent provided for under the LLP agreement, should be allowed as a tax deduction when arriving at the LLP's chargeable income. In the hands of Ali and Baba, the salaries constitute employment income and are taxed as such.

Distribution of profits
Under a partnership, the remaining share of divisible income represents the share of partnership profits to be taxed at the partners' level.

In the case of the LLP, as it is a taxable entity, taxes would be paid at the LLP level. The subsequent distribution of profits by the LLP to Ali and Baba would be exempt from income tax in their hands.

(ii) LLP

Chargeable income for the year of assessment 2015

	RM'000
Profit before tax	1,650
Less: Interest	(500)
	1,150
Add: Partners' salaries	Nil
Holiday trip for Ali	20
Depreciation	100
Entertainment for existing customers (50% deduction)	50
Other deductible expenses	Nil
Adjusted income	1,320
Less: Capital allowance (10% x RM2,500,000)	(250)
Statutory income	1,070
Less: Unabsorbed tax losses brought forward from the partnership	(300)
	770
Interest income [s.4(c)]	500
Chargeable income	1,270

Tutorial note: *The capital allowance claim in the LLP is based on the original acquisition cost of the assets to the partnership under the controlled transfer provisions. No initial allowances are claimable in the LLP.*

5 (a) Harold's estate

(i) Devolution of assets on the executor

The devolution of the assets of a deceased person on his executor under a will is deemed to take place for a consideration equal to their original acquisition price, i.e. this is a no-gain no-loss transaction and, therefore, no real property gains tax (RPGT) is payable.

(ii) Disposal of the shop house by the executor

In relation to the disposal of the shop house, RPGT will be chargeable on the executor of the estate. Where an asset of a deceased person is disposed of by the executor (other than to a legatee or beneficiary under the will), the executor is deemed to have acquired the asset on the date of the death of the deceased person at an acquisition price equal to the market value of the asset as at the date of death.

In this case, the acquisition price will be the market value on 15 July 2013, i.e. RM800,000. As the disposal of the asset is made within three years from the date of Harold's death, the chargeable gain will be subject to RPGT at 30%. Therefore, the RPGT payable will be RM60,000 ((RM1,000,000 – RM800,000) x 30%).

(iii) Transfer of apartment to James

The transfer of the apartment to James is made in lieu of a money legacy. It is provided that where a legatee accepts an asset in place of a money legacy, there is deemed to be an acquisition of the asset by the legatee at an acquisition price equal to the lower of the amount of the money legacy or the market value of the asset as at the date of transfer of its ownership to the legatee.

In this case, the market value of the apartment at the date of transfer is RM400,000 whilst the money legacy was for RM350,000. Therefore, the acquisition price of the apartment for James for RPGT purposes would be RM350,000.

The date of acquisition of the property is deemed to be the date of the transfer of ownership of the asset to James, i.e. 1 October 2015.

(iv) Transfer of property to Jill

Bungalow in Kuala Lumpur
Where an asset of a deceased person is transferred to a legatee by the executor under a will, there shall be deemed to be an acquisition of the asset by the legatee at an acquisition price equal to the market value of the asset as at the date of transfer of its ownership to the legatee. The acquisition date is taken to be the date of transfer of the ownership of the asset. Therefore, for Jill, the acquisition price and acquisition date would be RM2·4 million and 1 October 2015 respectively.

Condominium in Singapore
As the condominium is located in Singapore, the transfer should not be subject to any RPGT exposure, because RPGT is only applicable to real properties located in Malaysia.

(b) Tax audit and tax investigation

A tax audit is carried out by the Inland Revenue Board (IRB) to ensure voluntary compliance with the tax laws and regulations. As such, a taxpayer selected for an audit will be notified by the IRB through a letter of notification. A taxpayer may request for such an audit to be deferred due to unavoidable circumstances and reasonable grounds.

A tax investigation, on the other hand, is conducted when a taxpayer is suspected of evading tax and a surprise inspection visit is conducted with the purpose of gathering evidence to ascertain the actual tax liability of the taxpayer. The inspection visit may be made to the taxpayer's business premises, residence, tax agent's premises, third parties and other premises as may be necessary. Unlike a normal tax audit, the taxpayer would not receive any advance notice of the visit and it is not possible for Magnolia Sdn Bhd to request for the investigation procedure to be delayed.

(c) Tax returns must be based on audited accounts

With effect from the year of assessment 2014, the return furnished by a company should be based on the accounts audited by a professional accountant, together with an auditors' report made by that accountant as provided under the Companies Act, 1965. Accordingly, the tax return of a company which is filed without signed audited accounts will not be valid as it is not a return submitted in accordance with the Income Tax Act, 1967 [s.77A]. In this respect, notwithstanding that BungaRaya Sdn Bhd may have filed its tax return on a timely basis, the IRB can impose penalties for failure by the company to furnish a return or give notice of chargeability.

In addition, if the company proceeds to file its tax return without audited accounts, it would not be possible to amend the return subsequently upon the finalisation and signing of the audited accounts (if there are changes to the financial position of the company) as there is no provision in the law which allows a revision or amendment where the original return has not been submitted in accordance with the law.

In conclusion, BungaRaya Sdn Bhd should be advised to consider the following:

– To expedite the finalisation and signing of the audited accounts before the tax submission deadline of 30 June 2016; or

– Alternatively, if this is not possible, to apply to the IRB for an extension of the time to file its tax return. Such an application must be based on valid reasons.

				Marks
1	**(i)**	**Export incentives**		
		Allowance for increased exports		
		How satisfied conditions		1 + 1 + 1 + 1 + 1
		Rate and quantum		2
		Mechanism		1·5
		Promotion of exports		
		How satisfied condition		1
		Quantum and mechanism		1
		Reliefs not mutually exclusive		0·5
			Available	11
			Maximum	9
	(ii)	**Lease payments**		
		Treated as an operating lease unless a deemed sale		1
		Machinery		
		Not a deemed sale, with reason		1·5
		Lease payment deductible		1
		Lift		
		Deemed sale, with reason		2
		Outright purchase, CA		1 + 1
			Available	7·5
			Maximum	7
	(iii)	**Withholding tax provisions**		
		Lease payment for machinery		
		Why withholding tax provisions applicable and rate		1 + 1
		Maintenance and repairs		
		Why withholding tax provisions applicable and rate		1 + 1
				4
	(iv)	**Consequence of non-compliance and mitigation**		
		Consequences – 3 x 1 mark		3
		How to mitigate		1 + 1
		Expense deductible		1
		Withholding tax and penalty still not deductible		1
			Available	7
			Maximum	6
	(v)	**Tax computation**		
		10 items – 0·5 marks each		5
	Professional marks			
	Format and presentation of the report			1
	Clarity and effectiveness of communication including logical flow			2
	Appropriate use of appendix			1
				4
				35

			Marks
2	**(a)**	**Transfer of assets**	
		(i) Business premises	
		No-gain-no-loss transaction, with reasons	3
		Why disadvantageous	3
		Tax planning	4
		Loan and interest deduction	1
		Available	11
		Maximum	9
		(ii) Office equipment	
		Controlled sale, with reasons	2
		Treatment	1 + 1 + 1
			5
		(iii) Patents	
		Not plant, no CA impact	1
		Proceeds are capital in nature, reasons	1·5
		Proceeds are revenue in nature, reasons	1·5
		Conclusion: capital in nature/not taxable	1
		Royalty treatment	
		Before transfer – Bijak's income treatment	1
		After transfer – BSB's income treatment	1
			7
	(b)	**Unabsorbed loss and CA**	
		Substantial change in shareholding	1
		Dormant company	1
		Previous business ceased	1
		Losses and CA lost	1
			4
			25

					Marks
3	(a)	(i)	**Group registration**		
			Only permitted if solely provides taxable supplies		1
			Rental of apartments exempt supply		1
			Orkid is a mixed supplier		1
					3
		(ii)	**GST treatment**		
			Management fees:		
			Charged to Mawar		1
			Charged to Orkid		1
			Advertising services:		
			To Orkid – connected person/not entitled to full input tax credit		2
			– to account based on open market value		1
			To private school – provision of free services not a supply		1
			– non-connected person, no GST		1
			Disposal of a printing machine:		
			Capital nature of asset not relevant to GST treatment		1
			Not an export as goods delivered locally, so standard rated		1·5
				Available	9·5
				Maximum	8
	(b)	(i)	**Industrial building allowance**		
			Necessary adjustments made by IRB		0·5
			Time limitation		1 + 0·5
			Applicability of time limitation given that there is no assessment		1·5
				Available	3·5
				Maximum	3
		(ii)	**Interest income**		
			Treatment of interest income		1
			Inability to utilise tax losses as separate investment source		1
			Imposition of 45% penalty is correct, with reason		1·5
				Available	3·5
				Maximum	3
		(iii)	**Gifts for IRB officers**		
			Return the two mobile phones		1
			Not permitted for a taxpayer to make gifts/IRB officers to take the gifts		1
			If directors insist, resign from acting on behalf of the company		1
					3
					20

				Marks
4	(a)	(i)	**Gembira Trust Fund**	
			Each item of income (5 x 0·5 marks)	2·5
			Special deduction	
			– permitted expenses (4 x 0·5 marks)	2
			– A x B/4C formula	1·5
			– 10% of A	0·5
			– Higher of two	0·5
			Available	7
			Maximum	6
		(ii)	**Cantik Sdn Bhd**	
			Treatment of non-taxable income	1
			Treatment of taxable income	1
			Treatment of tax credit	1
				3
	(b)	(i)	**Partnership v LLP**	
			Treatment of interest income	1 + 1
			Treatment of partners' salaries	1 + 1
			Treatment of profit distribution	1 + 1
				6
		(ii)	**Chargeable income of LLP**	
			Each tax adjustment to arrive at adjusted income (6 x 0·5 marks)	3
			CA calculation	1·5
			Unabsorbed tax losses	1
			Interest income (as a separate source)	0·5
			Available	6
			Maximum	5
				20

		Marks
5 (a)	**Harold's estate**	
(i)	Devolution of assets on the executor	2
(ii)	**Disposal of asset by the executor**	
	Subject to RPGT, with reason	1
	Acquisition price and date	1 + 0·5
	RPGT payable	0·5
		3
(iii)	**Acquisition price and date for James**	
	Basis for determining the acquisition price	2
	Acquisition price	0·5
	Acquisition date	0·5
		3
(iv)	**Acquisition price and date for Jill**	
	Bungalow in KL: basis for determining the acquisition price	2
	acquisition price and date	0·5 + 0·5
	Condominium in Singapore	1
		4
(b)	**Tax audit and tax investigation**	
	Difference in terms of purpose	1 + 1
	Difference in terms of prior notice	1·5
	Ability to delay investigation procedures	1·5
	Available	5
	Maximum	4
(c)	**Tax returns and audited accounts**	
	Need for return to be based on audited accounts	1
	Late submission penalty even though tax return filed	1
	Cannot submit revised/amended return, with reason	1·5
	Advice on options (2 x 1 mark)	2
	Available	5·5
	Maximum	4
		20

Examiner's report
P6 (MYS) Advanced Taxation
June 2016

ACCA

General Comments

The examination consisted of two sections. Section A is compulsory and is made up of Question 1 for 35 marks and Question 2 for 25 marks, while Section B contained three questions of 20 marks each, from which candidates had to answer two questions.

Most candidates attempted all four questions, and there was little evidence of time pressure. Where questions were left unanswered by candidates, this appeared to be due to a lack of knowledge, as opposed to time pressure.

One issue is found to be somewhat prevalent: not reading the question requirement closely enough and therefore providing irrelevant answers.

Specific Comments

Question One
This 35-mark question was based on a manufacturing company and tested candidates' knowledge relating to export incentives, finance leases and withholding tax provisions.

Part (i) for 9 marks required candidates to explain why the company qualified for the two stated export incentives and their respective mechanisms. Some candidates provided the requisites of another export incentive, that of the "Malaysian International trade company" instead of the "allowance for increased exports". Yet other candidates wrote about the "enhanced allowance for increased exports" despite the fact that the latter was clearly excluded by the shareholding structure given in the scenario.

Part (ii) for 7 marks examined the rudiments of the Leasing Regulations 1986, i.e. that a finance lease arrangement is treated in the same manner as an operating lease unless the lease transaction is a "deemed sale". Some candidates correctly identified one of the leased assets as a "special purpose asset". However, they did not know how to follow through to conclude that it was therefore a deemed sale, and that the asset qualified for capital allowance based on the full cost as it was not in the nature of a hire-purchase transaction.

Parts (iii) and (iv) for a total of 10 marks tested the application of withholding tax provisions, consequences of non-compliance and measures to mitigate such consequences. Although the withholding tax scenarios involving lease rentals and technical services were straight forward, some candidates did not appropriately answer about the applicability of withholding tax provisions and the consequences of non-compliance. The part about mitigating the consequences was also not well answered.

Many candidates did not perform well on this question. Future candidates are urged not to neglect the tax fundamentals such as withholding tax. They should always read the question requirements closely and carefully so that they answer to the point.

Question Two
This 25-mark question covered the topics of real property gains tax (RPGT), controlled sale and shareholder continuity on the transfer of tangible and intangible assets from a sole proprietorship to

a dormant company acquired and controlled by the sole proprietor. It also tested the capital versus revenue arguments as well as classification of income.

This question was answered reasonably well. The application of controlled sale provisions was well done. Nevertheless, there are three shortfall areas.

Firstly, many candidates did not realise that a no-gain-no-loss outcome was disadvantageous in this scenario and that a simple tax plan was to structure it as a normal "plain vanilla" disposal rather than a disposal for a consideration substantially in shares. Also, a number of candidates were confused over the 75% of the consideration being satisfied in shares and the individual's 70% shareholding in the company taken over by him.

Secondly, some candidates did not read the scenario carefully enough to register that the four patents that produced royalties were disposed of and that they were required to determine the capital or revenue status of the disposal proceeds, not of the royalties received.

Thirdly, majority of candidates did not consider the significance of the total change of shareholding in a dormant company. They went on to talk at length about carry forward of losses and capital allowance with no reference to the shareholder continuity rules.

Question Three
This 20-mark optional question consists of part (a) testing GST for the first time in this paper, and part (b) relating to tax audit adjustments and professional ethics.

Of the minority that selected this question, many did not directly answer why group registration was denied and how the four services provided were to be treated GST-wise. That said, there were some very good answers provided to this part.

Candidates' response to Part (b) regarding the classification of interest income revealed that many of candidates did not have the updated knowledge of the amendment introduced in 2014 with regard to interest income being statutorily regarded as investment income in most cases.

In this connection, candidates are reminded that they must learn and apply the updated tax provisions.

It is encouraging to note that the ethics question in this part was well answered.

Question Four
This 20-mark optional question comprised two separate parts: part (a) relating to the taxation of a unit trust and a unit holder, while part (b) dealt with the taxation of a limited liability partnership (LLP).

This question was well answered.

The following few weak points were noted. Some candidates exhibited some confusions over a unit trust with a Real Estate Investment Trust (REIT) and a normal trust. As regards the treatment of partners' salaries in an LLP, while most candidates clearly stated that these were deductible if they are provided in the LLP deed, many did not go on to state that salaries thus paid were to be taxed as employment income in the hands of the partners. Some candidates did not read the question requirement carefully to register that they should comment on the tax treatment of distribution of profits by a partnership and an LLP, rather than how much each entity can distribute.

Question Five

This 20-mark question was made up of three parts:

Part (a) for 12 marks required a discussion of RPGT treatment of the transfer of assets under various circumstances after the death of the owner- individual.

Part (b) for 4 marks explored the differences between a tax audit and a tax investigation.

Part (c), also for 4 marks, tested the statutory requirement (introduced in 2014) that a company tax return must be based on audited accounts.

All three parts were well responded to.

Examiner's report

P6 Advanced Taxation (MYS)
September 2016

ACCA

General Comments
The examination consisted of two sections. Section A contained Q1 for 35 marks and Q2 for 25 marks, both questions being compulsory. Section B contained three questions of 20 marks each, from which candidates had to answer two questions.

This paper does contain a certain amount of technical material but a significant part of the examination is based around the application of the fundamental tax principles. The questions are largely practical rather than merely theoretical.

There is no substitute for proper understanding of the tax subject matter and practising their application to simulated scenarios. It would be beneficial to avoid rote-learning, and instead aim to establish a strong foundation in tax principles, tackling more scenarios (based on real life examples) allowing candidates to practise their skills in application.

Specific Comment

Question One
This question examines the different methods that a company could use to distribute its accumulated assets to its shareholders and compares the impact of capital reduction and liquidation. It also tests interest-free loans to shareholder-directors and the applicability of stamp duty in a specific scenario.

Candidates generally understood the capital nature of capital reduction and the attendant expenses, but quite a few candidates did not understand that the liquidation process and the related expenses would lead to the termination of the company.

The return of capital and its non-assessability were well understood by most candidates. However, a dividend in specie (in the form of shares) and its related implications regarding stamp duty on the transfer of shares were not well understood beyond the fact that it was a single-tier dividend.

As regards interest-free loans, many candidates wrote generally about anti-avoidance and transfer pricing when they should zero in on the specific anti-avoidance provision about loans to directors who hold at least 20% of the share capital. This was unexpected given that there was a technical article available on the ACCA website which covered this topic in the first half of 2016.

Question Two
This question dealt with tax incentives regarding technology and intellectual property. It also examined the transfer of tangible and intangible assets, with a requirement for a supporting computation to demonstrate the application of these measures.

Parts (a), (b) and (c) relating to acquiring a foreign-owned company with technology patents purchased and developed in house provided a good indication of how well prepared candidates were.

Part (d) relating to tangible assets in the form of delivery trucks was surprisingly not well answered considering it concerned the fundamental tax principles of old business assets being replaced by new ones.

Question Three
This question examined the tax treatment of miscellaneous receipts such as grants, subsidies, awards and scholarships.

Candidates generally performed reasonably well here, still with some room for improvement.

There was also ground for reasoned arguments under general principles which would have yielded some marks, but this was not taken up by many candidates.

Question Four
This question dealt with the topic of real property gains tax (RPGT) with a focus on the determination of the acquisition prices of different tranches of shares in a real property company.

Performance in this question was below expectations. It is an area that allows the candidates to apply learned knowledge to the given scenario.

The four marks allocated for the administrative aspects were not achieved by some candidates despite these being rudiments of RPGT.

Question 5
This question examines the taxation of deceased estates and the GST treatment of a transfer of a business as a going concern (TOGC).

Part (a) relating to the chargeable person and time lines for assessments when an individual dies were relatively well answered although some candidates did not accurately pin down the three-year timeline for assessments by the Director General.

Part (b) for the tax computation of the deceased estate and the beneficiaries was generally well done.

Part (c) relating to TOGC was generally not well responded to. That said, some candidates did correctly answer this part which shows they had come to the exam prepared.

Professional Level – Options Module

Advanced Taxation (Malaysia)

September/December 2016 – Sample Questions

Time allowed: 3 hours and 15 minutes

This question paper is divided into two sections:

Section A – BOTH questions are compulsory and MUST be attempted

Section B – TWO questions ONLY to be attempted

Tax rates and allowances are on pages 2–4

Do NOT open this question paper until instructed by the supervisor.

This question paper must not be removed from the examination hall.

Paper P6 (MYS)

Think Ahead ACCA

The Association of Chartered Certified Accountants

SUPPLEMENTARY INSTRUCTIONS

1. You should assume that the tax rates and allowances shown below will continue to apply for the foreseeable future.
2. Calculations and workings should be made to the nearest RM.
3. All apportionments should be made to the nearest whole month.
4. All workings should be shown.

TAX RATES AND ALLOWANCES

The following tax rates, allowances and values are to be used in answering the questions.

Income tax rates

Resident individual
Chargeable income

			Rate	Cumulative tax
	RM	RM	%	RM
First	5,000	(0 – 5,000)	0	0
Next	15,000	(5,001 – 20,000)	1	150
Next	15,000	(20,001 – 35,000)	5	900
Next	15,000	(35,001 – 50,000)	10	2,400
Next	20,000	(50,001 – 70,000)	16	5,600
Next	30,000	(70,001 – 100,000)	21	11,900
Next	150,000	(100,001 – 250,000)	24	47,900
Next	150,000	(250,001 – 400,000)	24·5	84,650
Next	200,000	(400,001 – 600,000)	25	134,650
Next	400,000	600,001 – 1,000,000)	26	238,650
Exceeding	1,000,000		28	

Resident company

Paid-up ordinary share capital	First RM500,000	Excess over RM500,000
RM2,500,000 or less	19%	24%
More than RM2,500,000	24%	24%

Non-residents

Company	24%
Individual	28%

Labuan entity – income from a Labuan trading activity

All chargeable profits	3%

Trust body – resident or non-resident

All chargeable income	24%

Personal deductions

		RM
Self		9,000
Disabled self, additional		6,000
Medical expenses expended on parents	(maximum)	5,000
Medical expenses expended on self, spouse or child with serious disease, including up to RM500 for medical examination	(maximum)	6,000
Parental care	(each)	1,500
Basic supporting equipment for disabled self, spouse, child or parent	(maximum)	6,000
Purchase of sports equipment	(maximum)	300
Study course fees for skills or qualifications	(maximum)	7,000
Expenses on books for personal use	(maximum)	1,000
Spouse relief		4,000
Disabled spouse, additional		3,500
Child – basic rate	(each)	2,000
Child – higher rate	(each)	8,000
Disabled child	(each)	6,000
Disabled child, additional	(each)	8,000
Life insurance premiums and contributions to approved funds	(maximum)	6,000
Private retirement scheme contributions, deferred annuity premiums	(maximum)	3,000
Medical and/or education insurance premiums for self, spouse or child	(maximum)	3,000
Purchase of a personal computer	(maximum)	3,000
Deposit for a child into the National Education Savings Scheme	(maximum)	6,000
Contribution to Social Security Organisation (SOCSO)	(maximum)	250

Rebates

Chargeable income not exceeding RM35,000	**RM**
Individual – basic rate	400
Individual entitled to a deduction in respect of a spouse or a former wife	800

Capital allowances

	Initial allowance (IA) Rate %	Annual allowance (AA) Rate %
Industrial buildings	10	3
Plant and machinery – general	20	14
Motor vehicles and heavy machinery	20	20
Office equipment, furniture and fittings	20	10
Agriculture allowance		
Buildings for the welfare of or as living accommodation for farm employees	nil	20
Other buildings used in the business	nil	10
All other qualifying agricultural expenditure	nil	50

Real property gains tax

Category of disposal	Companies Rate %	Individuals – Non-citizens and non-permanent residents Rate %	All others Rate %
Disposal within three years after the date of acquisition	30	30	30
Disposal in the fourth year after the date of acquisition	20	30	20
Disposal in the fifth year after the date of acquisition	15	30	15
Disposal in the sixth year after the date of acquisition or thereafter	5	5	0

Goods and services tax (GST)

Standard rate	6%

Stamp duty

Rates of duty under the First Schedule
Conveyance, assignment, transfer or absolute bill of sale

	Rate %
Sale of property	
For every RM100 or fractional part thereof:	
On the first RM100,000	1
On the next RM400,000	2
On the excess over RM500,000	3
Sale of company shares	
On every RM1,000 or fractional part thereof	0·3

Section A – BOTH questions are compulsory and MUST be attempted

1 You, a senior associate, and your tax director attended a meeting with Mr David Cooper, the Vice President Finance of Smart Incorporated (SI), at the office of Tax Firm on 5 December 2016. Below are the notes of that meeting prepared by you.

Extracts from notes of meeting

SI is a multinational group of companies based in the USA. SI plans to set up a manufacturing facility in Malaysia to produce smart watches. Towards this end, SI has incorporated a company in Malaysia, Very Smart Malaysia Sdn Bhd (VSM), with a paid-up ordinary share capital of RM500,000. VSM will commence the construction of its factory in January 2017 and expects to commence production from 1 January 2018.

The financial projections for the new project in Malaysia provided by Mr David were as follows:

Financial year ending 31 December	2017	2018	2019	2020	2021	2022
	RM'000	RM'000	RM'000	RM'000	RM'000	RM'000
Profit/(loss) before tax	(500)	(300)	3,000	7,000	8,000	9,000
Depreciation		1,000	1,000	1,000	1,000	1,000
Qualifying capital expenditure	10,000	5,000	nil	nil	nil	500

VSM expects to receive the first invoice for the factory construction on 1 January 2017.

SI understands from the Malaysian Investment Development Authority (MIDA) that the proposed project is eligible for a tax incentive with enhanced features as 'smart watch' is listed as a promoted product under the 'high technology' category.

The above financial projections have not taken into account the cost of financing the project because SI has not decided how best to do this. Two financing alternatives are being considered: (1) to provide VSM with a 5% (market rate) interest-bearing loan; or (2) to subscribe for 5% fixed cumulative preference shares in VSM. Whichever alternative is chosen, the funds will be made available to VSM in the first quarter of 2017. A total of RM20 million will be required to fund the factory construction as well as VSM's working capital.

VSM has employed one of SI's US engineers to oversee the construction of the factory. The engineer entered Malaysia on 16 November 2016 and he is expected to leave the country after seven months when the construction project ends on 15 June 2017.

While awaiting the commencement of manufacturing, VSM will procure products from its group manufacturing facility in Japan and sell these on to its customers in South East Asia. For VSM's Malaysian and Singapore customers, the products would be shipped to Malaysia first before they are distributed to the customers. For VSM's customers in other South East Asian markets, the products would be shipped directly from Japan to the respective customers' locations even though VSM will be issuing the invoices to these customers.

VSM has recently secured a contract with a Malaysian customer and agreed a first product delivery date in February 2017. The monthly trading turnover under this contract is expected to be more than RM1 million.

Mr David has sought tax advice as follows:

– the type of tax incentive to apply for;
– the more tax efficient alternative of financing the Malaysian project;
– the Malaysian tax treatment of the US engineer and any strategy that can be adopted to minimise the engineer's tax liability; and
– whether VSM should register for goods and services tax (GST) and, if so, when, and the GST treatment of its trading activities.

Having read the notes of the meeting, your tax director has sent you an email with the following instructions:

Please draft a letter to Mr David which addresses the following issues:

(i) Tax incentives available
Identify and explain the incentives available to VSM and the mechanism by which the incentives are given.

(ii) Choice of tax incentive
Provide an explanation of the attributes of the project which would influence the choice of incentive, together with comparative calculations of VSM's tax liability for the years of assessment 2018 to 2022. State our recommendation on the choice of the tax incentive based on your calculations.

For the purposes of these calculations, the capital allowances available will be as follows:

Year of assessment	RM'000
2018	4,350
2019	1,650
2020	1,650
2021	1,650
2022	1,820

Your comparative calculations should ignore any costs of financing.

(iii) Choice of financing options during the incentive period
Explain the tax treatment of the two alternative financing options and state our recommendation on the more tax efficient option, bearing in mind the tax incentive to be applied and the ability of VSM to pay the financing cost during the initial years.

(iv) Tax position of the US engineer in Malaysia
Explain how the engineer will be taxed in Malaysia and, based on his tax residence status for the years 2016 and 2017, advise how he might minimise his overall Malaysian tax liability.

(v) GST registration
Explain when VSM should register for GST and the impact on the claim of input tax on both its trading profits and the cost of the factory's construction.

(vi) GST treatment of trading activities
Prepare a table identifying the various supplies involved in VSM's proposed trading activities while it awaits the commencement of manufacturing from its factory and the GST implications thereof.

Required:

Draft the letter to Mr David Cooper, as instructed by your tax director.

The following marks are available:

(i) Incentives available and the mechanism for relief. (4 marks)

(ii) Preferred tax incentive. (8 marks)

(iii) Tax efficient mode of financing. (6 marks)

(iv) Tax implications for the US engineer. (6 marks)

(v) Goods and services tax (GST) registration. (3 marks)

(vi) GST treatment of the proposed trading activities. (4 marks)

Professional marks will be awarded in question 1 for the appropriateness of the format and presentation of the letter and the effectiveness with which the information is communicated. (4 marks)

(35 marks)

2 Subur Holdings Berhad, a company listed on Bursa Malaysia and its two subsidiaries have been a client of Tax Firm for many years. The following information regarding the Subur group of companies has been gathered from the tax files.

Information from the tax files

The Subur group comprises the following entities:

– Subur Holdings Berhad (SHB) – The activities of SHB are investment holding and the trading of palm oil products. SHB's annual trading turnover is in excess of RM100 million, and it also receives annual dividend and interest income of approximately RM10 million.

– Plantation Subur Sdn Bhd (PSSB) – A wholly owned subsidiary of SHB, PSSB is involved in the cultivation of oil palm.

– Oleo Subur Sdn Bhd (OSSB) – A wholly owned subsidiary of PSSB, OSSB owns and operates a refinery which produces downstream oleochemical products.

From the tax computations of the relevant companies, the following were noted:

– All three companies make up accounts to 31 December annually.

– SHB has unutilised tax losses from its trading business.

Your tax director has forwarded you an email he has received from the finance director of SHB:

Email from the finance director

To: Tax director, Tax Firm
From: Finance director, SHB
Subject: Proposed reorganisation exercise

Dear Tax director,

I refer to the above matter.

We plan to embark on a group reorganisation exercise to streamline our existing operations. I am pleased to inform you that we have decided to engage your firm to advise us on the tax aspects of this exercise.

Broadly, we are looking at reorganising ourselves into three divisions, namely, upstream (plantation), downstream (refinery) and trading. To achieve this, we plan to do the following:

– Incorporate a new subsidiary, Marketing Subur Sdn Bhd (MSSB) to be 100% owned by SHB.

– SHB to transfer its business of trading in palm oil products to MSSB. The management has specifically identified the following items to be transferred – office equipment, customer database, inventories, trade receivables and provision for retirement benefits.

– Transfer the shares in OSSB held by PSSB to SHB.

We also plan for SHB to charge management fees to its subsidiaries. Based on the current head office cost, we do not expect the total charge to exceed RM2 million a year.

I will get my secretary to arrange a meeting with you next week to move this forward.

Meanwhile, please contact me if you require further clarifications.

Regards,
Finance director

In preparation for the meeting, your tax director has instructed you to carry out some preliminary work.

Your tax director's instructions

Please carry out the following work in relation to Subur Group:

(a) Tax position of SHB following the reorganisation
Explain the tax status of SHB after the transfer of the trading business and the treatment of the company's relevant income sources after the reorganisation is completed.

(b) Transfer of the trading business
Explain the income tax treatment of the items to be transferred from SHB to MSSB from the perspective of both companies. Provide suggestions as to the advice we can give the client to improve its tax position on the transfer.

Remember that SHB has unutilised tax losses arising from the trading business.

(c) Transfer of the shares
Explain the income tax and stamp duty implications arising from the transfer of the OSSB shares from PSSB to SHB, including the conditions that need to be met in order to take advantage of any available reliefs.

Required:

Carry out the work as instructed by your tax director.

The following marks are available:

(a) Tax position of Subur Holdings Berhad (SHB) after the reorganisation. (7 marks)

(b) Transfer of the trading business from SHB to Marketing Subur Sdn Bhd (MSSB). (11 marks)

(c) Transfer of shares in Oleo Subur Sdn Bhd (OSSB) from Plantation Subur Sdn Bhd (PSSB) to SHB. (7 marks)

(25 marks)

Section B – TWO questions ONLY to be attempted

3 **(a)** On 1 December 2016, Mr Otak, aged 43 years, tendered his resignation from X Sdn Bhd. His last working day will be 31 December 2016, by which date he will have been employed with X Sdn Bhd for 12 years and ten months. Mr Otak is in good health and has resigned to pursue employment opportunities in other fields of work.

Privately, both parties have agreed that in return for X Sdn Bhd paying Mr Otak a sum of RM150,000 being compensation for a restrictive covenant, Mr Otak will refrain from joining a competitor employer in Malaysia within 18 months of his cessation of employment with X Sdn Bhd.

However, officially, Mr Otak has told X Sdn Bhd that he would prefer the RM150,000 payment to be termed an 'early retirement gratuity' in recognition of his past services and contributions.

Whichever option is pursued, the RM150,000 payment will be paid to Mr Otak on his last day of service with X Sdn Bhd.

Required:

(i) Explain the tax treatment of the RM150,000 in the hands of Mr Otak as

(1) compensation for a restrictive covenant; or
(2) a gratuity.

You should identify the basis periods involved, as well as the amounts subject to tax or eligible for tax exemption. (6 marks)

(ii) Based on the explanations in (i) above, advise Mr Otak on what he should do differently in order to minimise his income tax exposure. (4 marks)

(b) Pursuant to a tax audit conducted on Mr M, an additional assessment of tax and penalty (for an incorrect return) of RM25,000 was raised on 23 January 2015 for the year of assessment 2013.

On 21 February 2015, Mr M filed an appeal in the prescribed form against the additional assessment with a written statement that it was excessive. As he did not hear from the Inland Revenue Board (IRB), Mr M did not pay the RM25,000.

On 30 June 2016, Mr M changed his residential address but to date has not informed the IRB.

On 30 November 2016, the IRB issued a certificate [under s.104] to prevent Mr M from leaving Malaysia. The notification of the certificate was sent to his old address by registered post. Thus Mr M was not aware that the certificate had been issued.

Yesterday, Mr M was stopped at the airport when he wanted to make a short business trip overseas.

Required:

(i) State when the additional tax of RM25,000 is due and payable. (1 mark)

(ii) Comment on the validity of Mr M's tax appeal and the absence of a response from the Inland Revenue Board (IRB). (4 marks)

(iii) Explain whether the issue of the certificate on 30 November 2016 is lawful and whether Mr M can sue the Government for denying him freedom of movement. (5 marks)

(20 marks)

4 Madam Kaya having learnt about the angel investment incentive scheme and despite not having any experience in the relevant field of business, applied to become an accredited angel investor in February 2013. She has never previously invested in shares.

Madam Kaya made the following approved investments under the scheme with funds from refinancing her house mortgage:

Date investment made	Investee company	% of share capital	Amount invested
10 March 2013	ABC Sdn Bhd	25%	RM350,000
28 December 2014	DEF Sdn Bhd	30%	RM130,000

Typically, the investee companies take three to five years to become profitable. Madam Kaya is not involved in the investee companies because she is too busy with her own business activities.

Details of Madam Kaya's income and donations for the years 2015 and 2016 are as follows:

	2015	2016
	RM	RM
Business 1 statutory income/(loss)	50,000	100,000
Business 2 statutory income/(loss)	(100,000)	(80,000)
Employment income	200,000	200,000
Approved donations	5,000	1,200

Madam Kaya is currently negotiating the disposal of both her investments and expects to make total gains of RM1 million from these sales.

Going forward, Madam Kaya intends to make further investments, either under the angel investment incentive scheme or elsewhere.

Required:

(a) Compute Madam Kaya's total income for each of the years of assessment 2015 and 2016. (8 marks)

(b) Explain the impact on the total income calculated for both years of assessment in (a) if Madam Kaya disposes of her investments in both ABC Sdn Bhd and DEF Sdn Bhd on 20 December 2016. (5 marks)

(c) Based on the facts given above, present the arguments for treating the expected total gains of RM 1 million as (1) capital gains or (2) revenue gains in the hands of Madam Kaya, and draw a reasoned conclusion. (7 marks)

(20 marks)

5 **(a)** PQR Sdn Bhd (PQR) was incorporated on 13 March 2000 with Alison and Bert each holding 50% of the ordinary share capital. On 1 April 2000, RM500,000 was injected into the company and the money was placed in fixed term deposits held in PQR's name with a Malaysian bank. On 10 October 2000, RM100,000 was withdrawn by PQR to be used as the deposit upon the signing of an agreement to acquire a ten-acre plot of land for RM300,000.

In 2011, a dispute arose between PQR and the owner of the neighbouring land, Mr T. Eventually, Mr T was ordered by the court to pay compensation of RM200,000 to PQR for causing damage to PQR's land. As settlement of the RM200,000 compensation, Mr T transferred legal title to a piece of adjoining land worth RM200,000 to PQR on 4 July 2013. On this date, the original ten-acre plot of land was valued at RM3 million, while PQR's bank deposits stood at RM50,000. As PQR has never actively traded, it held no other assets.

Alison died on 31 December 2013 and her holding of shares in PQR was transferred to her son on 2 June 2014, at which date the market value of her shares was RM2 million. In 2015, Bert migrated overseas and renounced his Malaysian citizenship.

On 1 December 2016, an offer of RM6 million was made for PQR's ten acres of land together with the adjoining land. As an alternative, the potential buyer has agreed to purchase 100% of the shares in PQR for RM6 million.

Required:

(i) Determine the real property company status of PQR Sdn Bhd on 10 October 2000 and 4 July 2013 respectively. (4 marks)

(ii) Compute the real property gains tax (RPGT) payable by PQR Sdn Bhd if it were to dispose of the land for RM6 million on 31 December 2016. (4 marks)

(iii) Compute the RPGT payable by Alison's son and Bert if they were to dispose of the PQR Sdn Bhd shares for RM6 million on 31 December 2016. In each case, provide an explanation of the respective acquisition date and price. (7 marks)

(b) Mr Bijak, a sole proprietor, has engaged Mr Algebra as his tax agent and made the following requests:

– Mr Bijak would like to cap his tax liability for the year of assessment (YA) 2016 at RM20,000 because he applied for his tax instalments to be reduced to RM14,000 in total for that YA and he wants to avoid any penalty for an excessive difference.

– Mr Bijak wants Mr Algebra to base his tax return for YA 2016 on a newly prepared set of accounts he has just given to him and not the set of accounts that Mr Algebra used to help him apply for a bank loan facility last month.

Required:

(i) Explain to Mr Bijak his responsibilities under the Income Tax Act with regard to the keeping of records and furnishing of tax returns, and the potential offences he may commit if his requests are carried out. (3 marks)

(ii) Explain the potential offence Mr Algebra may commit, and the potential consequences, if he proceeds to comply with Mr Bijak's requests. (2 marks)

(20 marks)

End of Question Paper

1 Letter to Smart Incorporated

Tax Firm
Any Street
50000 Kuala Lumpur
Malaysia

Mr. David Cooper
Vice President Finance
Smart Incorporated
Any Street
New York
US

8 December 2016

Dear Mr David,

Further to our meeting on 5 December 2016, we would like to set out the tax issues and implications in relation to your proposed investment in a manufacturing facility in Malaysia. We have also included in the letter some suggestions on how the tax efficiency of the project can be improved based on the information provided during our above mentioned meeting.

(i) Tax incentive available

As Very Smart Malaysia Sdn Bhd (VSM) intends to establish a factory to manufacture a promoted high technology product (the smart watch), it qualifies for enhanced benefits as compared to the standard incentive package offered by the Government. The company can choose either the pioneer status or the investment tax allowance (ITA) incentive. These two incentives are mutually exclusive and the tax incentive application must indicate the incentive applied for.

Pioneer status

If VSM applies for pioneer company status, it will be accorded a full (100%) income tax exemption of the statutory income of the 'smart watch' manufacturing project for its first five years of production (the pioneer period). Statutory income basically refers to the income of the company after deducting tax allowable expenses and capital allowances.

The income exempted can be credited into a tax exempt income account from which tax exempt dividends can be distributed.

ITA

Alternatively, if claimed, the ITA is based on the capital expenditure incurred by VSM. Under this incentive, an additional allowance equal to 60% of the qualifying capital expenditure (factory building and plant and machinery) can be claimed for five years. The ITA claimed/absorbed can be used to exempt up to 100% of the statutory income of the proposed project. Any unutilised ITA can be carried forward indefinitely to be utilised against the future taxable income of the project.

Similar to the pioneer status incentive, the income exempted by the ITA is credited into a tax exempt income account from which tax exempt dividends can be distributed.

(ii) Preferred tax incentive

As both pioneer status and the ITA incentives are mutually exclusive, it is important that VSM chooses the right/optimum tax incentive to maximize its tax advantage. As pioneer status is given based on the profits earned in the first five years, this incentive would generally be preferred for projects which are profitable but with low/moderate capital investment. On the other hand, the ITA would give a better outcome if the project is capital intensive and there is a relatively long gestation period before the project becomes profitable.

Based on the financial projections provided, we attach a simulation of the tax position of VSM during the five-year incentive period. This indicates that pioneer status would give a better outcome as the company would not be in a tax paying position for the first five years of operation whilst under the ITA incentive, the company would have a tax liability of RM2,779,000.

Based on the above, we recommend that VSM apply for pioneer status.

(iii) Tax efficient mode of financing

In financing the project, SI is considering either providing VSM with an interest-bearing loan or subscribing for preference shares in VSM. The tax implications of the two options are discussed below.

Interest-bearing loan

Interest expenses paid qualify for a tax deduction if the interest is in respect of a loan used in the production of gross income or laid out on an asset used in the production of the gross income of the company. Therefore, as the loan will be utilised to finance the construction and working capital of VSM's manufacturing business, the interest incurred by VSM and paid to SI in the US should be tax deductible.

Tutorial note: *The interest deduction may be restricted under the thin capitalisation rules which are expected to be implemented from 1 January 2018 onwards.*

However, as VSM will only commence its manufacturing activity in January 2018, any interest incurred prior to the commencement of the manufacturing business will not be deductible.

Also, if VSM opts for pioneer status, the interest deduction for the first five years will only serve to reduce the amount of income to be exempted and does not therefore generate any tax benefit to the company.

In addition, the interest payment to SI, being a payment of interest to a non-resident, will be subject to Malaysian withholding tax at the rate of 15%. The withholding tax must be remitted to the Inland Revenue Board (IRB) within one month after paying or crediting the amount to the non-resident.

Interest is payable whether or not VSM is profitable. Thus, SI is assured of its return on the loan.

Preference shares
If SI subscribes for preference shares in VSM, the return for the financing would take the form of a dividend, which, being a profit appropriation, is not deductible by VSM for tax purposes.

If VSM opts for the pioneer status incentive, the non-deductibility of the dividends is not an issue for the first five years of production as the income of the company will be exempt from tax.

The preference share dividend, being a single-tier dividend, is tax exempt in the hands of SI and no further tax exposure accrues to SI on the dividend.

It should however be noted that dividends can only be paid out of profits available in VSM. As VSM is not expected to register profits in the initial two years, it will not be able pay any preference dividend to SI until it becomes profitable in 2019.

Conclusion
It may be more tax efficient for VSM to finance the project through a subscription of preference shares as this avoids any withholding tax deduction. However, SI must be mindful that it may not be able to receive any dividend until VSM becomes profitable.

(iv) Tax position of the US engineer
The engineer will be employed by VSM to oversee the construction of the factory in Malaysia. Therefore, his employment income will be subject to tax in Malaysia as it is in respect of an employment being exercised in Malaysia. However, the applicable tax rate will depend on the engineer's tax residence status.

The engineer is expected to be in Malaysia for seven months from 16 November 2016 to 15 June 2017. If this is the case he will be in Malaysia for 46 days for the basis year 2016 and for 166 days in the basis year 2017, which is less than the 182 days necessary for him to become a resident. Hence based on the current work schedule, the US engineer will not be tax resident in either the year of assessment (YA) 2016 or YA 2017.

As a non-resident, the engineer will be subject to tax at the flat rate of 28% and he will not be eligible for personal reliefs; whereas as a resident, he would be subject to graduated tax at rates from 0% to 28% and he would be eligible for personal reliefs.

Therefore, we should advise that the US engineer consider extending his stay in Malaysia until at least 1 July 2017, so that he will be in Malaysia for the requisite 182 days in the year 2017. This will qualify him as a tax resident for YA 2017 [s.7(1)(a)]. Also, as he is in Malaysia for 182 days for the basis year 2017, he will qualify for tax residence in YA 2016 as his physical presence in the year 2016 is linked to a consecutive period of 182 days in the following basis year [s.7(1)(b)].

(v) Goods and services tax (GST) registration
Based on the supply contract concluded, VSM will commence making taxable supplies from February 2017 onwards. Given the expected RM1 million monthly turnover, the registration threshold of RM500,000 will be exceeded in that month. Therefore, VSM should immediately register itself as a taxable person for GST purposes.

Once VSM is registered for GST, it will be able to claim the input tax incurred on the importation of the products from Japan. Similarly, VSM will also be able to claim the input tax incurred on the factory construction. There is no requirement to wait for the manufacturing operations to commence in order to claim the input tax as long as VSM has valid tax invoices for the construction works.

(vi) GST treatment of the proposed trading activities

The GST implications for the various supplies involved in VSM's proposed trading activities are summarised in the table below:

Nature of transaction	GST treatment
Importation of goods for customers in Malaysia and Singapore	This is the importation of taxable goods into Malaysia, so is subject to GST at 6%.
Sale of products to Malaysian customers	These sales are taxable supplies taking place in Malaysia, so will be subject to GST at 6%.
Sale of products to Singapore customers	These sales are regarded as the export of goods from Malaysia, so will be GST zero rated (0%).
Sale of products to other South East Asian markets	As the goods are to be delivered directly to the customers from Japan, the supply is not made in Malaysia since the goods are not removed from a place in Malaysia. As such, GST is not applicable.

We trust that we have adequately addressed your concerns. Meanwhile, please do not hesitate to contact us should you require further clarifications on any of the above matters.

Yours faithfully,

Tax director

Enclosure

Appendix

Comparative calculations of tax incentives for the proposed manufacturing project

Option 1: Pioneer status

Year of assessment	**2018**	**2019**	**2020**	**2021**	**2022**
	RM'000	**RM'000**	**RM'000**	**RM'000**	**RM'000**
Profit before tax	(300)	3,000	7,000	8,000	9,000
Depreciation	1,000	1,000	1,000	1,000	1,000
Adjusted income	700	4,000	8,000	9,000	10,000
Less: Capital allowance	(700)	(4,000)	(2,950)	(1,650)	(1,820)
Statutory income	Nil	Nil	5,050	7,350	8,180
Pioneer exemption – 100%	Nil	Nil	(5,050)	(7,350)	(8,180)
Chargeable income	Nil	Nil	Nil	Nil	Nil
Tax liability at 24%	Nil	Nil	Nil	Nil	Nil
Unabsorbed CA carried forward					
(RM4,350,000 – RM700,000)	3,650				
(RM3,650,000 + RM1,650,000 – RM4,000,000)		1,300			
(RM1,300,000 + RM1,650,000 – RM2,950,000)			Nil	Nil	Nil

Total tax liability: Nil

Option 2: Investment tax allowance (ITA)

Year of assessment	**2018**	**2019**	**2020**	**2021**	**2022**
	RM'000	**RM'000**	**RM'000**	**RM'000**	**RM'000**
Statutory income (per above)	Nil	Nil	5,050	7,350	8,180
ITA (up to 100%) (working)	Nil	Nil	(5,050)	(3,950)	Nil
Chargeable income	Nil	Nil	Nil	3,400	8,180
Tax liability at 24%	Nil	Nil	Nil	816	1,963

Total tax liability: RM2,779,000

Working: ITA claim

Year of assessment	**2018**	**2019**	**2020**	**2021**	**2022**
	RM'000	**RM'000**	**RM'000**	**RM'000**	**RM'000**
Total qualifying expenditure					
(RM 10,000,000 + RM5,000,000)	15,000				Nil*
ITA at 60%	9,000	Nil	Nil	Nil	Nil
Amount brought forward	Nil	9,000	9,000	3,950	Nil
Amount utilised	Nil	Nil	(5,050)	(3,950)	Nil
Amount available for carry forward	9,000	9,000	3,950	Nil	Nil

* As the first qualifying expenditure was incurred on 1 January 2017, the tax relief period for ITA would be from 1 January 2017 to 31 December 2021. Therefore, the capital expenditure incurred in the year of assessment 2022 is not eligible for an ITA claim.

2 Subur group

(a) Tax status and treatment of Subur Holdings Berhad (SHB) after the reorganisation

Based on the reorganisation plan, SHB will cease its trading business in palm oil products and start charging management service fees to its subsidiaries. With the cessation of its trading business, SHB's investment income (i.e. dividend and interest income) will be more than 80% of its total gross income. This is because the management fee income at a maximum of RM2 million will only account for 16·7% of the total gross income [RM2 million/(RM10 million + RM2 million)]. As such, SHB is likely to become an investment holding company for tax purposes [s.60FA].

As SHB will be a listed investment holding company, its investment income will be deemed a business source. However, any excess deductions and capital allowance from these deemed business sources will be disregarded.

The provision of management services will be treated as a separate business source. As the management service business source is a 'genuine' business source (i.e. not a deemed business source), any unabsorbed capital allowance or adjusted losses can be carried forward. Also, any current year tax losses from the management services business can be utilised to shelter the aggregate statutory business income of the company (i.e. the deemed business income).

The unutilised losses of SHB from the transferred trading business in palm oil products may be set-off against the future combined statutory income from both the genuine and deemed businesses of SHB.

(b) Transfer of the trading business from SHB to Marketing Subur Sdn Bhd (MSSB)

Office equipment
As SHB will have claimed capital allowance on these assets, the transfer of the equipment should fall within the controlled transfer provisions [Paragraphs 38 and 39, Schedule 3]. Under these provisions, the assets are deemed to have been transferred at the residual expenditure (RE) of the transferor, i.e. SHB and hence no balancing charge or balancing allowance will arise for SHB. On the other hand, the transferee, MSSB, will only be entitled to claim annual allowances (no initial allowances permitted) based on the original acquisition cost of the assets restricted to the balance of the RE of the assets transferred. The transfer price between SHB and MSSB is disregarded under the 'controlled transfer/sale' situation.

Customer database
As this represents a capital asset of SHB, any excess or gain arising from the transfer of the asset would not be subject to income tax.

For MSSB, the amount paid would not be tax deductible as it is expenditure on acquiring a capital asset. As an intangible asset, it will not qualify for capital allowances.

Inventories
When a person permanently ceases to carry on its business, and at or about the time of cessation, the stock in trade of the business is sold or transferred for valuable consideration to another company which intends to use the stock in its business, the transfer value is taken to be an amount equal to the price paid on the sale or to the value of the consideration [s.35(5)].

In view of this, as SHB has unutilised tax losses, the inventories should be transferred for consideration equal to their market value in order to generate profits which can be sheltered by those tax losses. MSSB will as a result inherit a higher cost base and therefore, on the subsequent sale of the stock to third party customers, the profits generated will be lower.

Trade receivables
The receivables transferred would constitute capital assets to MSSB and any subsequent write-off of debts arising from their irrecoverability would not be tax deductible. Conversely, any writeback or recoveries of the debts transferred would not be taxable on MSSB.

It is therefore essential to ensure that prior to the transfer, SHB makes reasonable specific provisions for the debts so as to enable SHB to obtain a tax deduction for the debts, which are reasonably estimated to be irrecoverable. Alternatively, consideration should be given to not transferring the receivables and for SHB to continue to collect the outstanding receivables from the customers.

Provision for retirement benefits
No tax deduction would be granted to SHB for the transfer of the provision for retirement benefits, since the expenses have not crystallised at the point of transfer to MSSB as such provisions are regarded as contingent liabilities. However, MSSB should be able to claim a tax deduction when the expense is incurred, i.e. on the subsequent payment of the retirement benefits to the employees who retire in the normal course.

(c) Transfer of shares in Oleo Subur Sdn Bhd (OSSB) from Plantation Subur Sdn Bhd (PSSB) to SHB

On the basis that the shares in OSSB are held by PSSB as a long term investment, the transfer of the shares to SHB would be regarded as a capital transaction. As such, any gains therefrom would not be subject to income tax.

The transfer of the shares would be subject to stamp duty at the rate of 0.3% based on the market value of OSSB. However, as the shares are being transferred between associated companies, stamp duty relief may be applicable [s.15A Stamp Act, 1949].

For this purpose, companies are 'associated" if:

(i) either company limited by liability holds at least 90% of the issued share capital of the other; or

(ii) a third company limited by liability holds at least 90% of the issued share capital of each of the companies limited by liability.

Stamp duty relief will not be available where:

(1) any part of the consideration for the transfer of the shares was received from a non-associated company; or

(2) the shares in OSSB were previously transferred to PSSB; or

(3) SHB and PSSB cease to be associated following the transfer of the shares.

As this is an internal reorganisation and there is no intention for there to be a change of shareholding relationship, the proposed transfer should qualify for stamp duty relief.

3 (a) Mr Otak

(i) Comparative tax treatment

If the RM150,000 is paid to Mr Otak as compensation for a restrictive covenant, he will be eligible for an income tax exemption [paragraph 15(1)(b), Schedule 6] of up to RM10,000 for each full year of service. As Mr Otak has 12 full years of service, RM120,000 (RM10,000 x 12 years) of the payment will be exempt from tax. The remaining RM30,000 (RM150,000 – 120,000) will be subject to tax as employment income for the year of assessment (YA) 2016.

If the RM150,000 is paid to Mr Otak as a gratuity, he will not qualify for a tax exemption for retirement gratuity [under paragraph 25, Schedule 6] even though he has worked with X Sdn Bhd for more than ten years. This is because, at 43 years of age, he has not attained either the statutory or contractual ages of retirement, being 55 years and 50 years, respectively. He is also not retiring due to ill health.

However, Mr Otak will be eligible for an exemption [under paragraph 25D, Schedule 6] of RM1,000 for every completed year of service, i.e. RM12,000 in total.

Therefore, the balance of RM138,000 (RM150,000 – RM12,000) will be subject to tax. Further, the entire sum of RM138,000 will be taxable in a single year, YA 2016, because pursuant to current laws [s.25(1) as amended with effect from the YA 2016], where gross income from employment is received in a relevant period, it is treated as gross income of that relevant period.

(ii) Tax advice

First, Mr Otak should not opt to receive a gratuity for past services: given that there is only limited exemption available to him for such a payment, as he is far from retirement age. Also, the true nature of the RM150,000 is that of compensation for a restrictive covenant and, as a compensation payment, Mr Otak will be eligible for exemption of RM120,000 and only suffer tax on RM30,000.

Further, Mr Otak should consider continuing his employment with X Sdn Bhd for another two months so that he can achieve an additional completed year of service with the same employer, thus qualifying for tax exemption of another RM10,000.

(b) Mr M

(i) Date of payment of additional tax

The amount payable under the additional assessment for YA 2013 of RM25,000 was due and payable on the service of the additional assessment, i.e. on the date the assessment was issued of 23 January 2015. This is the case notwithstanding that Mr M has appealed against the assessment [s.103(2)].

(ii) Tax appeal and Inland Revenue Board (IRB) non-response

The appeal was made in time, i.e. within 30 days after the issue of the assessment, and it was properly made in writing using the prescribed form. However, the appeal was not duly supported with technical arguments and documentary evidence: it merely stated that the additional assessment was excessive.

On the other hand, the IRB's lack of response also did not fulfil its obligations to review the appeal, call for further information if necessary, or otherwise respond to the appeal within 12 months of the date of receipt of the appeal. The IRB also does not appear to have applied for an extension of time from the Minister of Finance for a further period of up to six months to review the appeal.

(iii) Validity of the issued certificate and legal action

Mr M has a duty under the Income Tax Act [s.89] to inform the IRB, in writing, of a change of address within three months of the change. Failure to do so constitutes an offence [under s.120(1)(d)] which, on conviction, is punishable with a fine in the range of RM200 to RM20,000 and/or six months' imprisonment.

As Mr M did not notify IRB of his change of address, the notice of the issue of the certificate [under s.104] did not reach him. The IRB has fulfilled its duty to serve the notice on him by registered post. Non-receipt of the notification does not invalidate the IRB's action of issuing the certificate [s.104(3) proviso].

It appears therefore that the certificate to prevent Mr M from leaving Malaysia has been lawfully issued. Pursuant to the law [s.104(5)], no legal proceedings can be instituted or maintained against the Government in respect of anything 'lawfully done' [under s.104].

Therefore, Mr M should be advised against taking legal action against the Government in preventing him from leaving the country.

4 Madam Kaya

(a) Total income for the years of assessment (YA) 2015 and 2016

	RM	2015 RM	2016 RM
Statutory income from			
Business 1		50,000	100,000
Business 2 (loss)		nil	nil
Statutory income from businesses		50,000	100,000
Less Unabsorbed loss brought forward		nil	(100,000)
Net statutory income from businesses		50,000	nil
Statutory income from employment		200,000	200,000
Aggregate income		250,000	200,000
YA 2015			
Less Approved investment under the angel tax incentive	350,000		
Restricted to	250,000	(250,000)	
Disregarded	100,000		
Approved donation disregarded	5,000		
Total income YA 2015		nil	
Unabsorbed loss carried forward	100,000		
YA 2016			
Less Approved investment under the angel tax incentive			(130,000)
			70,000
Current year loss	80,000		
Absorbed	(70,000)		(70,000)
Unabsorbed loss carried forward	10,000		
Approved donation disregarded	1,200		
Total income YA 2016			nil

(b) Disposal of investments on 20 December 2016

Under the approved investment in the angel tax incentive scheme, the tax exemption is subject to the investment being held for at least two years from the date the investment is made.

If Madam Kaya disposes of the investments on 20 December 2016 the respective holding periods are as follows:

	Date of investment	Date of disposal	Holding period
ABC Sdn Bhd	10 March 2013	20 December 2016	3 years 9 months
DEF Sdn Bhd	28 December 2014	20 December 2016	1 year 11 months

Therefore, if the disposal takes place on 20 December 2016 as proposed, the exemption of RM250,000 in YA 2015 in respect of the investment in ABC Sdn Bhd will remain intact as the holding period has exceeded the minimum period of two years. So, Madam Kaya's total income for YA 2015 will remain unchanged (i.e. at nil)

However, with regard to the investment in DEF Sdn Bhd, the tax exemption of RM130,000 will not be granted when computing the total income of YA 2016 because the investment will have been held for less than two complete years.

The entire loss of RM80,000 and the donation of RM1,200 will then be able to be fully absorbed and Madam Kaya's total income for YA 2016 will become RM 118,800 (RM200,000 – RM80,000 – RM1,200).

(c) Treatment of gains: capital or revenue

Arguments for capital gains treatment

- Madam Kaya does not regularly deal in investments
- She refinanced her mortgage to raise funds to invest. Her annual income is sufficient to support the servicing of the loan instalments. Thus, she did not have to buy and sell in short timeframes.
- She has no related interest in the investee companies' businesses.
- She does not exercise any control nor participate in the businesses carried out by the investee companies: she was merely an investor.
- The investments were made with the sole purpose of financing the activities of the investee companies to obtain a legitimate tax shelter in the form of a tax exemption.

Arguments for revenue gains treatment

- Her status as an accredited angel investor shows that she is serious about investing and making gains therefrom.
- The short holding period indicates that she meant to buy and sell to realise profits in short timeframes.
- Repetition – she invested twice within a short time span, and she intends to invest in other investee companies.
- Finance – the fact that she borrowed money through refinancing her mortgage shows that she does not intend to hold on to the investments for long as the investee companies do not expect to pay dividends in the short term.
- Organisation – she went through the process of being accredited as an angel investor, made applications to the Government to invest in the investee companies, made informed choices regarding the companies to invest in: all point towards organisation to carry out a business activity.
- She clearly has intention to seek profits by repeatedly investing and disposing of her investments as an angel investor.

Conclusion
On balance, the arguments for a trade intention and revenue gains are stronger because of the repeated transactions of buying and selling and the effort required in investing and disposing of the shares in the incentive scheme.

5 (a) PQR Sdn Bhd (PQR)

(i) Real property company (RPC) status

On 10 October 2000
PQR is a controlled company and it acquired real property on this date.

The proportion of real property against total tangible assets on 10 October 2000 was 300,000/(300,000 + cash of (500,000-100,000)) = 42.86%. Therefore, PQR was not an RPC on 10 October 2000.

On 4 July 2013
On this date, a real property worth RM200,000 was transferred to PQR as settlement of a debt owing to PQR. PQR has effectively ‘acquired’ a real property. It is therefore necessary to reassess its RPC status on this date.

The defined value of its real properties at 4 July 2013 is RM3,200,000 (i.e.RM3 million being the market value for the ten-acres of land + RM200,000 for the adjoining land). Total tangible assets as at 4 July 2013 are RM3,250,000 (RM3,200,000 + cash of RM50,000).

The proportion of real properties to total tangible assets is 98.46% (3,200,000/3,250,000). Therefore, PQR became an RPC on 4 July 2013 as the defined value of its real property is not less than 75% of the value of its total tangible assets.

(ii) Real property gains tax (RPGT) on disposal of the land by PQR

	Ten acres of land RM	RM	Adjoining land RM
Disposal consideration			
6,000,000 x 3,000,000/3,200,000		5,625,000	
6,000,000 x 200,000/3,200,000			375,000
Acquisition consideration	300,000		
Less Compensation for damage	(200,000)		
Acquisition price		(100,000)	(200,000)
Chargeable gain		5,525,000	175,000
Acquisition on 10 October 2000			
Disposal on 31 December 2016			
Disposal in the 17th year			
RPGT at 5%		276,250	
Acquisition on 4 July 2013			
Disposal on 31 December 2016			
Disposal in the fourth year			
RPGT at 20%			35,000

(iii) RPGT on the disposal of the PQR shares

Alison's son is deemed to have acquired the RPC shares in PQR when the shares were transferred to him on 2 June 2014. He is deemed to have acquired the RPC shares at their market value at that date of RM2 million.

Bert is deemed to have acquired the RPC shares on 4 July 2013 when PQR became an RPC. As PQR was not an RPC when he first acquired the shares on 13 March 2000, his deemed acquisition price of the RPC shares is arrived at by reference to the formula A x B/C = (RM3,000,000 + RM200,000) x 50% = RM1,600,000.

	Alison's son RM	Bert RM
Disposal price		
6,000,000/2	3,000,000	3,000,000
Acquisition price	(2,000,000)	(1,600,000)
Chargeable gain (CG)	1,000,000	1,400,000
Exemption: greater of		
RM10,000 and 10% x CG	(100,000)	(140,000)
Gain subject to RPGT	900,000	1,260,000
Acquisition on 2 June 2014		
Disposal on 31 December 2016		
Disposal in the third year		
RPGT at 30%	270,000	
Acquisition on 4 July 2013		
Disposal on 31 December 2016		
Disposal in the fourth year		
RPGT at 30% (no longer a citizen)		378,000

(b) (i) Mr Bijak

As a taxpayer, Mr Bijak is obliged to maintain sufficient records upon which he will base his tax return. The tax return he furnishes to the Inland Revenue Board (IRB) is expected to be based on true and fair records and accounts.

His request for pre-determining his tax liability at RM20,000 and keeping two sets of books for different purposes will therefore contravene the requirements of the Income Tax Act. In fact, it is tantamount to wilful evasion, fraud, wilful default and negligence, which are serious offences [s.114(1)].

(ii) Mr Algebra

As a tax agent, if Mr Algebra complies with Mr Bijak's request, he will be knowingly assisting his client in preparing a tax return that understates his tax liability, which is an offence [under s.114(1A)]. On conviction, the court may impose a fine (RM2,000 to RM20,000) and/or three years' imprisonment.

				Marks
1	**(i)**	**Type of incentive**		
		Pioneer status, rate and mechanism		0·5 + 1 + 1
		ITA, rate and mechanism		0·5 + 1 + 1
		Mutually exclusive		0·5
			Available	5·5
			Maximum	4
	(ii)	**Preferred tax incentive to be applied**		
		Project attributes for each incentive		1 + 1
		Narrative re figures and conclusion		1·5
		Statutory income calculation		1·5
		Pioneer status calculation		1
		ITA calculation		2
		2022 expenditure non-qualifying		1
			Available	9
			Maximum	8
	(iii)	**Tax efficient mode of financing**		
		Interest:		
		Deductible with reason		1
		Pre-commencement		1
		Impact on pioneer incentive		1
		Payable regardless of profitability		0·5
		WHT on interest		1
		Dividend:		
		Appropriation so no deduction		0·5
		Impact on pioneer incentive		1
		Single tier dividend, exempt		0·5
		Only payable if profitable		0·5
		Conclusion		1
			Available	8
			Maximum	6
	(iv)	**Tax position of US engineer**		
		Taxability of employment income		1
		Tax residence status for YA 2016 and 2017, with reason		0·5 + 0·5 + 0·5
		Impact of residence status on tax rate and personal reliefs		1 + 1
		Advice re extending stay		2
			Available	6·5
			Maximum	6
	(v)	**GST registration**		
		Registration threshold exceeded February 2017		0·5
		Register immediately		0·5
		Input tax on procurement of trading products from Japan		1
		Input tax on construction works		1·5
			Available	3·5
			Maximum	3

			Marks
(vi)	**GST implications**		
	Each supply – identify + GST treatment (0·5 + 0·5) x 4		4
	Professional marks		
	Format and presentation of the letter		1
	Clarity and effectiveness of communication including logical flow		2
	Appropriate use of appendix / table		1
			4
			35

2	**(a)**	**SHB post reorganisation**		
		Becomes a listed IHC with reasons		2
		Investment income deemed business source, treatment of excess deductions/CAs		1 + 1
		Management fees a separate business source		1
		Treatment of unabsorbed CAs/losses		1 + 1
		Treatment of unutilized trading losses		1
			Available	8
			Maximum	7
	(b)	**Transfer of trading business**		
		Office equipment:		
		Controlled transfer		1
		Mechanism in SHB and MSSB		1 + 1
		Customer database:		
		Capital, not taxable		0·5 + 0·5
		Not deductible and no CAs		0·5 + 0·5
		Inventories:		
		S.35(5) provision		1
		Advise MV consideration and effect		1 + 0·5
		Trade receivables:		
		Capital asset for MSSB and effect		1 + 0·5
		Make specific provision in SHB		1
		Consider no transfer		1
		Provision for retirement benefit:		
		SHB not deductible		1
		MSSB deductible when incurred		1
			Available	13
			Maximum	11
	(c)	**Transfer of shares in OSSB**		
		Income tax – capital		1
		Stamp duty – rate, market value of company		0·5 + 1
		Stamp duty relief:		
		Transfer between associated companies		1
		Meaning of associated company		1
		Conditions: consideration, beneficial interest, cannot cease to be associated		1 + 1 + 1
			Available	7·5
			Maximum	7
				25

					Marks
3	**(a)**	**(i)**	**Comparative tax treatment**		
			Compensation for restrictive covenant:		
			Exemption available and application to Mr Otak		1·5
			Tax position including YA		0·5 + 0·5
			Gratuity:		
			Exemption available and application to Mr Otak		
			Retirement gratuity		1·5
			Ill health		0·5
			Remaining exemption		1
			Tax position including YA		0·5 + 1
				Available	7
				Maximum	6
		(ii)	**Tax advice**		
			Nature of payment		2
			Extend employment and impact		2
					4
	(b)	**(i)**	**Date of payment**		
			Due and payable on the service of the additional assessment		1
		(ii)	**Tax appeal and non-response**		
			Appeal: in time, in writing/ prescribe form		1 + 0·5
			But appeal was not duly supported		1·5
			IRB's obligation – review within 12 months, apply for extension of 6 months		1 + 1
				Available	5
				Maximum	4
		(iii)	**Validity of certificate and legal action**		
			Duty to inform change of address; within three months		1 + 0·5
			Offence, fine/imprisonment		0·5 + 1
			Certificate is lawfully issued with reasons		0·5 + 1
			Non-receipt is no plea		0·5
			Contemplated legal action is not possible		1
				Available	6
				Maximum	5
					20
4	**(a)**		**Total income**		
			YA 2015		4
			YA 2016		4
					8
	(b)		**Disposal on 20 December 2016**		
			Two year condition		1
			Holding periods		0·5 + 0·5
			Impact on YA 2015		1
			Impact on YA 2016		1 + 1
					5
	(c)		**Capital or revenue**		
			Capital gains – arguments – 1 mark each, maximum		4
			Revenue gains – arguments – 1 mark each, maximum		4
			Conclusion		1
				Available	9
				Maximum	7
					20

				Marks
5	**(a)**	**(i)**	**RPC status of PQR**	
			Controlled company	1
			On 10 October 2000 – not a RPC with reasons	1·5
			On 4 July 2013 – RPC with reasons	2·5
			Available	5
			Maximum	4
		(ii)	**RPGT on disposal of land**	
			Ten acres of land	2·5
			Adjoining land	2
			Available	4·5
			Maximum	4
		(iii)	**RPGT on disposal of shares**	
			Alison's son	
			RPC shares deemed acquisition date and price	0·5 + 0·5
			Chargeable gain and exemption	0·5 + 0·5
			Holding period and tax rate	0·5 + 0·5
			Bert	
			RPC shares deemed acquisition date and price	0·5 + 1
			Chargeable gain and exemption	0·5 + 0·5
			Holding period and tax rate	0·5 + 1
				7
	(b)	**(i)**	**Mr Bijak**	
			Duty to maintain sufficient records upon which he will base his tax return	1
			Pre-determining his tax liability and keeping two sets of books contravenes this	1
			Tantamount to wilful evasion, fraud, wilful default and negligence	1
				3
		(ii)	**Mr Algebra**	
			Assisting a client prepare a tax return that understates his tax liability	1
			Offence, fine and/or imprisonment	1
				2
				20

Examiner's report
P6 (MYS) Advanced Taxation
December 2016

ACCA

General Comments

The examination consisted of two sections. Section A contained Q1 for 35 marks and Q2 for 25 marks, both questions being compulsory. Section B contained three questions of 20 marks each, from which candidates had to answer two questions.

The level of preparedness on the part of many candidates was disappointing in this session. It must be emphasised that there is no substitute for proper and comprehensive understanding of the entire syllabus. Candidates would do well if they build a strong foundation in tax principles and practise their skills by applying them to simulated inter-connected multi-faceted scenarios.

It is noted that certain question parts were not responded to by some candidates. Candidates are strongly urged to refrain from spotting topics for preparation: tax issues tend to be inter-connected, so it is not advisable to leave out some topics.

Candidates are once again urged to read the questions and the requirements carefully and refrain from writing down all they know about a topic, without thinking out whether these were relevant in the context of the given scenario/facts.

Specific Comments

Question One

This 35-mark question examines the typical issues of a potential investor: selection of the optimum investment incentive, the tax-efficient method of funding the investment, personal tax issues of key personnel, and GST issues.

Parts (i) and (ii) concern the comparative benefits and mechanism of the tax incentive measures of pioneer status and investment tax allowance. Many candidates earned no marks for writing about the eligibility and pre-requisites, when the emphasis should be more on how each incentive works and on the relative tax savings. Some candidates suggested applying for increased export and reinvestment allowance, which was not relevant in the scenario: this was a new business and there were no facts at all relating to increase in exports or reinvestment.

Part (iii) deals with the relative merits of debt or equity financing "bearing in mind the tax incentive... and the ability to pay financing cost during the initial years". Many candidates wrote generally about paying interest or dividend, but did not address the fact that an interest deduction may not be desirable during the tax relief period, and that the business would be profitable only in the third year.

Part (iv) pertains to the tax treatment of a non-resident individual coming to work in Malaysia for seven months straddled over two calendar years. It mainly calls for tax planning to minimise his overall Malaysian tax liability "based on his tax residence status". Many candidates correctly suggested that he extend slightly his stay in Malaysia in 2017 to qualify for tax residence for both 2016 and 2017, thereby qualifying for personal tax reliefs and the preferential scale rates. Yet many candidates wondered whether he was seconded and who paid his remuneration when the facts clearly stated he was "employed" by the Malaysian company. Some also suggested seeking exemption under double tax treaty when he was stated to be from the US, a non-treaty country (the limited Malaysia-US treaty only covers sea and air transport activities). This points to candidates not reading the facts carefully.

Parts (v) and (vi) relate to GST: the need for registration, the claim for inputs, and the applicability of GST output regarding four sets of trading transactions. Many candidates did not attempt these parts, indicating their non-preparedness. On the other hand, a number of candidates performed well here, obviously because they were duly prepared.

Question Two

This 25-mark question examines the issues arising from a group reorganisation: listed investment holding company (LIHC), tax implications of transfer of business and intra-group transfer of shares.

Part (a) relating to the LIHC was reasonably well attempted. Some candidates did not respond to this part, indicating they were not prepared for this topic.

Part (b) for 11 marks requires candidates to discuss the tax treatment of the transfer of business to a subsidiary, namely office equipment, customer database, inventories, trade receivables and provision for retirement benefits. This was well responded to, except for the provision for retirement benefits.

Part (c) basically tests the eligibility for relief from stamp duty. This was poorly attempted.

Question Three

This 20-mark question contains two parts, one dealing with lump sum receivable from employment while the other tested aspects of tax administration.

Part (a) for 10 marks relates to a lump sum payment upon cessation of employment income and requires tax planning. Most candidates performed well in this part.

Part (b) tests the validity of a tax appeal and the DGIR's responsibility. Many candidates did not appreciate the fact that the appeal was not duly supported with grounds and that specific timelines applied for DG's response to the appeal.

Question Four

This 20-mark question in three parts relates to an angel investor but it tests general tax principles as well. The performance regarding the treatment of the investment made by an angel investor was better than the performance on fundamental principles such as the treatment of business losses, and capital-versus-revenue arguments. This should not be.

Question Five

This 20-mark question tests real property gains tax (RPGT) issues in part (a), while part (b) deals with the taxpayer's responsibilities and a tax adviser's ethics.

Part (a) for 15 marks comprehensively tests the determination of real property company status, the computation of RPGT for a company, a legatee and a non-citizen. This part was reasonably well done although performance could have been better.

Part (b) for 5 marks tested the taxpayer's responsibility to keep sufficient and authentic records and the tax adviser's ethics. Some candidates robotically wrote that a taxpayer must keep records for seven years and file tax return by 30 June of the following calendar year. These aspects were not relevant in the context of the given scenario.

Examiner's report

P6 (MYS) Advanced Taxation
March 2017

General Comments

The examination consisted of two sections. Section A contained Q1 for 35 marks and Q2 for 25 marks, both questions being compulsory. Section B contained three questions of 20 marks each, from which candidates had to answer two questions.

Candidates are urged to read the questions and the requirements carefully and refrain from writing down all they know about a topic, without thinking about whether it is relevant in the context of the given scenario/facts.

Comprehension does not come easily in this intrinsically technical subject. It does not come through rote learning but through a proper understanding of the subject matter. The subject lends itself to a principles approach whereby the candidate understands the principles and applies them in given scenarios culled from practical experience. The examination out of necessity does contain a certain amount of technical material, but a significant part of the examination is based around the application of the fundamental principles.

Specific Comments

Question One

The first part of this question required candidates, for six marks, to discuss the various tax incentives available to the business carried out by the company in question, under two possible ownership options. Candidates were then required in the second and third parts of the question to explain the treatment of unabsorbed losses, capital allowances and incentives under each option.

Candidates were then required to prepare comparative tax computations under each option and to provide a recommendation of the preferred option.

The fifth part tested the treatment of rental income under various circumstances: where services directly related to the main business activity were provided, and where ancillary services were provided.

Some candidates did not consider the two alternative options, thus losing valuable marks. The main weakness demonstrated was an incomplete understanding of the incentive measures, hence the inability to compute the comparative outcomes. The rental part was discussed very superficially and often candidates did not consider the underlying basic concepts of business income versus investment income.

This question was not satisfactorily dealt with.

Question Two

The first part of this question, for four marks, dealt with another tax incentive measure while the remaining 21 marks involved the application of knowledge of basis periods and goods and services tax (GST) in the context of the incentive company.

In answering the parts regarding basis periods, some candidates appeared to be unaware of the prevailing law as they referred to the previous law which has been replaced since 2014.

The final part of the question relating to GST on the lease of agricultural land was poorly attempted, due mainly to an incomplete grasp of the subject matter.

This question was generally not well done.

Question Three

The first part of Question 3 presented various scenarios of receipts by a young person, testing the principles of whether revenue in nature, whether foreign-sourced, and whether settlement applied.

Most candidates scored good marks for this part. Nevertheless, they did miss scoring even more marks because they did not justify sufficiently why a receipt was revenue in nature, why it was foreign sourced or why it was settlement income.

The second part of the question required the preparation of a tax computation for the young person. This was well done.

This question was popular amongst candidates and generally well responded to.

Question Four

This question was selected by fewer candidates, compared to Question 3 and Question 5.

The first part of this question, for eight marks, dealt with tax planning and anti-avoidance, while the second part on real property gains tax (RPGT) took up the remaining 12 marks.

Part (a) required the explanation of the anti-avoidance provision, and how a reorganisation may be defended if the anti-avoidance provision were to be invoked.

Part (b) tested how a RPGT relief was applicable to a group restructuring.

Both parts were not as well answered as would have been expected.

Question 5

The first part tested the reasoned selection of employment remuneration package based on simulated tax computations. This was very well answered.

The second part involved various aspects of tax administration and dealt with the basis of derivation of income.

This was responded to reasonably well.

Professional Level – Options Module

Advanced Taxation (Malaysia)

March/June 2017 – Sample Questions

Time allowed: 3 hours and 15 minutes

This question paper is divided into two sections:

Section A – BOTH questions are compulsory and MUST be attempted

Section B – TWO questions ONLY to be attempted

Tax rates and allowances are on pages 2–4

Do NOT open this question paper until instructed by the supervisor.

This question paper must not be removed from the examination hall.

Paper P6 (MYS)

Think Ahead ACCA

The Association of Chartered Certified Accountants

SUPPLEMENTARY INSTRUCTIONS

1. You should assume that the tax rates and allowances shown below will continue to apply for the foreseeable future.
2. Calculations and workings should be made to the nearest RM.
3. All apportionments should be made to the nearest whole month.
4. All workings should be shown.

TAX RATES AND ALLOWANCES

The following tax rates, allowances and values are to be used in answering the questions.

Income tax rates

Resident individual
Chargeable income

	RM	RM	Rate %	Cumulative tax RM
First	5,000	(0 – 5,000)	0	0
Next	15,000	(5,001 – 20,000)	1	150
Next	15,000	(20,001 – 35,000)	5	900
Next	15,000	(35,001 – 50,000)	10	2,400
Next	20,000	(50,001 – 70,000)	16	5,600
Next	30,000	(70,001 – 100,000)	21	11,900
Next	150,000	(100,001 – 250,000)	24	47,900
Next	150,000	(250,001 – 400,000)	24·5	84,650
Next	200,000	(400,001 – 600,000)	25	134,650
Next	400,000	600,001 – 1,000,000)	26	238,650
Exceeding	1,000,000		28	

Resident company

Paid up ordinary share capital	First RM500,000	Excess over RM500,000
RM2,500,000 or less	19%	24%
More than RM2,500,000	24%	24%

Non-residents

Company	24%
Individual	28%

Labuan entity – income from a Labuan trading activity

All chargeable profits	3%

Trust body – resident or non-resident

All chargeable income	24%

Personal deductions

		RM
Self		9,000
Disabled self, additional		6,000
Medical expenses expended on parents	(maximum)	5,000
Medical expenses expended on self, spouse or child with serious disease, including up to RM500 for medical examination	(maximum)	6,000
Parental care	(each)	1,500
Basic supporting equipment for disabled self, spouse, child or parent	(maximum)	6,000
Purchase of sports equipment	(maximum)	300
Study course fees for skills or qualifications	(maximum)	7,000
Expenses on books for personal use	(maximum)	1,000
Spouse relief		4,000
Disabled spouse, additional		3,500
Child – basic rate	(each)	2,000
Child – higher rate	(each)	8,000
Disabled child	(each)	6,000
Disabled child, additional	(each)	8,000
Life insurance premiums and contributions to approved funds	(maximum)	6,000
Private retirement scheme contributions, deferred annuity premiums	(maximum)	3,000
Medical and/or education insurance premiums for self, spouse or child	(maximum)	3,000
Purchase of a personal computer	(maximum)	3,000
Deposit for a child into the National Education Savings Scheme	(maximum)	6,000
Contribution to Social Security Organisation (SOCSO)	(maximum)	250

Rebates

Chargeable income not exceeding RM35,000	**RM**
Individual – basic rate	400
Individual entitled to a deduction in respect of a spouse or a former wife	800

Capital allowances

	Initial allowance (IA) Rate %	Annual allowance (AA) Rate %
Industrial buildings	10	3
Plant and machinery – general	20	14
Motor vehicles and heavy machinery	20	20
Office equipment, furniture and fittings	20	10
Agriculture allowance		
Buildings for the welfare of or as living accommodation for farm employees	Nil	20
Other buildings used in the business	Nil	10
All other qualifying agricultural expenditure	Nil	50

Real property gains tax

	Companies	Individuals – Non-citizens and non-permanent residents	All others
	Rate %	Rate %	Rate %
Category of disposal			
Disposal within three years after the date of acquisition	30	30	30
Disposal in the fourth year after the date of acquisition	20	30	20
Disposal in the fifth year after the date of acquisition	15	30	15
Disposal in the sixth year after the date of acquisition or thereafter	5	5	0

Goods and services tax (GST)

Standard rate	6%

Stamp duty

Rates of duty under the First Schedule
Conveyance, assignment, transfer or absolute bill of sale

	Rate %
Sale of property	
For every RM100 or fractional part thereof:	
On the first RM100,000	1
On the next RM400,000	2
On the excess over RM500,000	3
Sale of company shares	
On every RM1,000 or fractional part thereof	0·3

Section A – BOTH questions are compulsory and MUST be attempted

1 You are a tax associate of Tax Firm. You and your tax director met with Tax Firm's new client, Serene Garment Sdn Bhd (SGSB), a company involved in the manufacturing of ladies' cotton garments. Below are the notes taken from this client meeting.

Notes of meeting with SGSB

– SGSB has a paid up ordinary share capital of RM10 million and is registered for goods and services tax (GST). SGSB's factory is located in Shah Alam, Malaysia.

– As part of its expansion plan, SGSB intends to undertake the following capital investment projects:

Project A: New factory building

SGSB plans to embark on the manufacturing of men's garments by investing in a new production facility. The total investment is expected to be RM4·5 million, made up as follows:

	Financial year ending 30 September		
	2017	2018	Total
	RM'000	RM'000	RM'000
New factory building (to be completed in October 2017)	1,500	1,000	2,500
Machinery (to be put into use in October 2017)	–	2,000	2,000
Total investment	1,500	3,000	4,500

Note: All amounts are quoted exclusive of GST.

The new machinery will be acquired under hire purchase as follows:

	RM
Cost of machinery	2,000,000
Down payment	200,000
Hire purchase loan	1,800,000
Number of instalments	24
First instalment due	1 October 2017

Project B: Yarn weaving machine

In view of increasing fabric prices, SGSB has decided to invest in a yarn weaving machine to produce cotton fabrics, which are the raw materials for its garment business. The machine will cost RM4,000,000 (exclusive of GST) and following the machine being put into use in August 2017, SGSB's cost of purchasing fabrics is expected to reduce by 50%.

– SGSB intends to claim the reinvestment allowance (RA) incentive in respect of both the above capital investment projects. SGSB first claimed RA in the year of assessment (YA) 2001.

– In its financial year ending 30 September 2017, SGSB has also incurred the following expenditure all of which has been expensed in the profit or loss account:

Chimney construction

The old chimney, forming part of the existing factory building, was damaged and needed to be rebuilt. Due to SGSB undertaking the yarn weaving activities in this building (Project B), the chimney needed to be heightened to meet the environmental requirements. The new chimney cost RM530,000 (inclusive of GST of RM30,000). According to the contractor, had the chimney not been required to be heightened, the replacement cost would only have been RM200,000. The input tax on this tax invoice has been claimed in SGSB's GST return.

Light bulbs

SGSB replaced the light bulbs used in its office at a cost of RM159,000 (inclusive of GST of RM9,000). The supplier's tax invoice was erroneously issued in the name of SGSB's parent company. As a result, the input tax on this tax invoice was not claimed in SGSB's GST return and the full amount of RM159,000 was expensed.

Notes of meeting with SGSB (continued)

Compensation payment to a neighbouring company

A neighbouring company to SGSB, Taylormade Sdn Bhd (TMSB), is currently involved in the manufacturing of silk garments. TMSB proposed to venture into the manufacturing of cotton garments. As the production of cotton garments would have been in direct competition to SGSB, it managed to persuade TMSB not to venture into the manufacturing of cotton garments. Instead, it was agreed that TMSB will refer all its orders for cotton garments to SGSB and that SGSB will reciprocate by referring all its orders for silk garments to TMSB. As part of this arrangement, SGSB is required to make a compensation payment of RM300,000 to TMSB. TMSB is a GST registrant.

– SGSB has computed the following tax projections, before taking into account the RA claim for YAs 2017 and 2018:

	Note	YA 2017 RM'000	YA 2018 RM'000
Adjusted income/(loss)	1	(500)	5,000
Capital allowance	2	2,000	2,000

Notes:

1. The adjusted income/(loss) has been calculated before taking account of any tax adjustments required for the expenditure relating to the chimney, light bulbs and compensation payment.
2. The capital allowance figures have taken into account the effect of the capital expenditure in Projects A and B but not the effect of any tax adjustments to be made to the adjusted income/(loss).

Your tax director has sent you an email requesting you to prepare a report for the board of directors of SGSB, which addresses the following:

(i) Whether, as a company, SGSB will be eligible for the RA incentive, and if so, when the incentive period will expire.

(ii) Assuming that SGSB as a company will be eligible for the RA incentive, the applicability of such an incentive claim to each of Project A and Project B. In each case you should clearly indicate whether, and if so how, each investment will be regarded as a qualifying (or a non-qualifying) project and where relevant, identify the eligible qualifying expenditure and the timing of the claim.

(iii) The income tax deductibility of the expenditure incurred on the construction of the chimney, light bulbs and the compensation paid to TMSB. In relation to the compensation payment, you should present the arguments for both its deductibility and non-deductibility and draw an appropriate conclusion.

(iv) Whether the input tax incurred by SGSB in respect of the chimney construction and the light bulbs will be allowed as an income tax deduction.

(v) Whether the compensation paid to TMSB will be subject to GST.

(vi) Illustrate the tax impact of the above items by computing SGSB's total income for each of the YAs 2017 and 2018, clearly identifying any amounts to be carried forward.

Required:

Draft the report to Serene Garment Sdn Bhd (SGSB) as instructed by your tax director.

The following marks are available:

(i) Eligibility for the reinvestment allowance incentive and its expiration date. (2 marks)

(ii) Applicability of the incentive claim for each of Project A and Project B. (6 marks)

(iii) Income tax deductibility of the expenditure incurred on the chimney construction, light bulbs and compensation payment. (9 marks)

(iv) Tax deductibility of the input tax incurred on the chimney construction and the light bulbs. (4 marks)

(v) Goods and services tax (GST) implications of the compensation payment. (3 marks)

(vi) Computations of SGSB's total income for each of the years of assessment 2017 and 2018. (7 marks)

Professional marks will be awarded in question 1 for the appropriateness of the format and presentation of the report and the effectiveness with which the information is communicated. (4 marks)

(35 marks)

2 Tax Firm has been appointed as the tax agent for Lamsah Berhad (LB) to prepare its income tax return for the year of assessment (YA) 2017. LB is a company listed on Bursa Malaysia and its principal activity is that of investment holding. In addition, to support its group, LB also provides management services to its subsidiaries.

The relevant financial information provided by LB for the preparation of its tax return is as follows:

Financial information for the year ended 31 March 2017

	RM'000
Revenue	
– Dividend from local subsidiaries	3,000
– Dividend from foreign subsidiaries	1,400
– Interest from local subsidiaries	4,600
– Fees for management services from subsidiaries	1,000
Other income	
– Gain from disposal of an investment	3,000
Investment balances (no movement during the year)	
Investment in local subsidiaries	80,000
Investment in foreign subsidiaries	50,000
Amount owing by local subsidiaries (interest-bearing)	110,000
Amount owing by local subsidiaries (non-interest-bearing)	10,000

Notes:

1. The direct expenses incurred in respect of the provision of the management services are RM200,000 for staff costs and RM100,000 for office overheads.
2. The interest expense incurred for the year is RM600,000, of which RM100,000 relates to the loan taken from a Labuan bank to finance investment in foreign subsidiaries.
3. The amount of common expenses after excluding the expenses in items 1 and 2 is RM1 million.
4. The current year capital allowance relating to the common assets is RM200,000.
5. During the financial year, due to the bearish stock market performance and to improve the share price of the company, LB carried out a share buyback exercise by which it purchased its own shares on the Bursa Malaysia at a cost of RM100,000. These shares are held as treasury shares. Half of the shares will be used to fulfil LB's obligations under an employee share award scheme to be given to its employees in the financial year ending 31 March 2018. The balance of the shares will be sold on the stock exchange market in the future, when the share price sufficiently improves.
6. Based on the tax computation for YA 2016, there was an excess of deductible expenses over gross income in respect of the management fee and interest income sources of RM100,000 and RM50,000 respectively.

Your tax manager has arranged a meeting next week with the finance director of LB to discuss the tax computation for YA 2017 as well as the income tax treatment of the share buyback made by the company.

In preparation for this meeting, your tax manager has requested you to carry out the following work:

(a) Investment holding company
Explain, with supporting calculations, why LB will be regarded as an investment holding company and its tax treatment as an investment holding company.

(b) Tax computation for YA 2017
Starting with the gross income from the respective sources, compute LB's total income for YA 2017. Each revenue or other income item should be reflected in this tax computation, indicating by the use of 'nil' any item for which no adjustment is required.

(c) Share buyback
Explain the income tax treatment of the share buyback in terms of:

- the initial purchase of the shares on the stock exchange market;
- the application of the shares to fulfil the share award scheme; and
- the future disposal of the shares on the stock exchange market.

Required:

Carry out the work as instructed by your tax manager.

The following marks are available:

(a) The tax status of Lamsah Berhad as an investment holding company. (7 marks)

(b) Tax computation for the year of assessment 2017. (12 marks)

(c) Tax treatment of the share buyback. (6 marks)

(25 marks)

Section B – TWO questions ONLY to be attempted

3 ForinCo, a company incorporated and operating in Ruritania with a paid up share capital of RM2 million, intends to expand its sales network to Malaysia. Beginning in July 2017, ForinCo will station a marketing manager in Malaysia to establish business contacts, collect local market information and exhibit ForinCo's products to businesses. On 1 December 2017, the marketing manager will report to ForinCo as to the feasibility and viability of doing business in Malaysia.

If the report is favourable, in January 2018, the marketing manager will proceed to establish a sales team, enter into contracts, maintain inventory and fulfil orders. It is expected that the Malaysian operation will pay interest and technical fees to the ForinCo head office in Ruritania.

ForinCo is seeking tax advice on whether to locally incorporate a wholly-owned subsidiary (with an issued share capital of about RM1 million) or to operate in Malaysia through a branch.

In the double tax agreement signed between Malaysia and Ruritania, the article relating to a permanent establishment is based on the standard clauses in the OECD model convention for double tax treaties.

Required:

(a) Assuming a positive feasibility report, explain whether ForinCo will have a permanent establishment in Malaysia in (1) 2017; and (2) 2018. (4 marks)

(b) Explain to ForinCo the comparative income tax treatment of a branch and a Malaysian-incorporated company with reference to each of the following aspects:

- **the deductibility of business expenses;**
- **the claiming of capital allowances in respect of the assets used in the Malaysian operations, including small value assets;**
- **the application of the withholding tax provisions on the payment of interest and technical fees to ForinCo head office;**
- **the tax rates applicable to the chargeable income; and**
- **the repatriation/distribution of profits.** (16 marks)

(20 marks)

4 (a) After a long absence, Mr Balik Kampong (BK) returned to live and work in Malaysia in September 2016. In November 2016, as a sole proprietor, BK rented a warehouse building from Madam Rich. During the period November 2016 to April 2017, BK incurred expenditure of RM300,000 on renovations to alter the building from a storage building into a factory, and installed plant and machinery costing RM200,000. On 1 May 2017, the raw materials arrived and the production of fine pottery began immediately. On 1 June 2017, the first shipment of finished goods was delivered to a customer overseas.

In addition to the above business venture, BK receives rental income from his residential property located overseas and dividend income from companies in Singapore and Malaysia.

BK has forecast his income for 2017 to be as follows:

	RM
Pottery business	
Turnover	1,000,000
Business expenses (all tax deductible)	(793,000)
Rental income from overseas property	90,000
Singapore dividend income	22,000
Malaysian dividend income	8,000

Required:

(i) Determine the date of commencement of the pottery business and the first basis period for the business. (5 marks)

(ii) Assuming that the business commenced in 2017, compute Mr Balik Kampong's (BK's) aggregate income for the year of assessment 2017, duly supported with explanations regarding the assessability or otherwise of each of his sources of income and his eligibility for capital allowances. (8 marks)

(iii) Explain Madam Rich's eligibility to claim industrial building allowance against her income from the letting of the warehouse to BK and the expenditure on which any such claim will be based. (3 marks)

(b) OneTwoThree Sdn Bhd (OTT) has filed its annual tax return on time every year since its commencement in 2009. In July 2015, the Inland Revenue Board (IRB) conducted a tax audit on OTT, reviewing the tax returns for the years of assessment 2010 to 2013 inclusive.

On 1 June 2017, OTT received an additional assessment for each of the four years of assessment 2010 to 2013, all dated 18 May 2017 and totalling RM100,000. The additional amount represents the tax on additional chargeable income arising from the company's directors remuneration being deemed excessive and disallowed, and the penalties for incorrect returns.

Required:

Explain the statutory time bar in the context of the case of OneTwoThree Sdn Bhd and state, for the additional assessments for each of the years of assessment 2010, 2011, 2012 and 2013, whether they were issued within the statutory time limit. (4 marks)

(20 marks)

5 DEF Sdn Bhd (DEF) paid a premium of RM180,000 on 1 May 2010 to secure a 30-year lease of a piece of freehold land in Pahang from Mr Pemilik. This is the first time Mr Pemilik has granted a lease of this property.

In addition, DEF paid annual rent of RM36,000 to Mr Pemilik. The annual rent is payable in advance every three years. DEF used the land for the storage of goods in its trading business.

On 1 May 2017, DEF sub-leased the land to XYZ Sdn Bhd (XYZ) at a premium of RM295,000 for the remaining duration of the lease. XYZ will be responsible for paying the annual rental to Mr Pemilik from this date.

On 5 June 2017, DEF disposed of a shophouse in Selangor because the location had become prone to flooding due to poor drainage. DEF incurred a loss of RM77,000 on this disposal, after taking into account all relevant and qualifying expenditure.

Required:

(a) Explain the income tax treatment of the premium and the annual rental paid to Mr Pemilik from the perspective of DEF Sdn Bhd (DEF). (5 marks)

(b) Explain the real property gains tax (RPGT) treatment of the grant of the sub-lease to XYZ Sdn Bhd by DEF, and the premium of RM295,000 received from the sub-lease. (3 marks)

(c) Compute the RPGT liability of DEF in the year of assessment 2017 in respect of the sub-lease, explaining the treatment of the loss of RM77,000 from the sale of the shophouse. (7 marks)

(d) Explain the income tax treatment of the premium and the annual rent received in advance from the perspective of Mr Pemilik. Where alternative feasible treatments are available, present both sets of arguments. (5 marks)

(20 marks)

End of Question Paper

1 Report to Serene Garment Sdn Bhd

From Tax Firm
To Board of directors, Serene Garment Sdn Bhd
Date 8 June 2017

Report on the tax treatment of the proposed capital investment projects and certain expenditure incurred by the company

We understand that Serene Garment Sdn Bhd (SGSB) intends to undertake some capital investment projects. This report outlines the eligibility of the company to avail itself of the reinvestment allowance (RA) incentive. In addition, the report will consider the tax treatment of certain expenditure incurred in relation to the chimney construction, light bulbs and the compensation paid to a neighbouring company, Taylormade Sdn Bhd (TMSB), for the financial year ending 30 September 2017.

(i) Eligibility for RA and its expiration period

A company which undertakes a qualifying project can avail of the RA provided that the company has been in operation for at least 36 months. Each company is allowed to claim the RA for 15 consecutive years from the year of assessment (YA) in which it first claims the RA.

We understand that SGSB first claimed RA in YA 2001. As such, the 15-year claim period would have lapsed in YA 2015.

However, for companies whose RA period has expired, the Government has announced a special extension whereby such companies can claim the RA for an additional three years commencing from YAs 2016 to 2018. Therefore, SGSB will be eligible to claim RA during this period but any capital expenditure incurred after YA 2018 will not be eligible for an RA claim.

(ii) Applicability of an RA claim for each project

SGSB intends to embark on two capital investment projects involving the construction of a new factory facility and the acquisition of a new yarn weaving machine respectively. The applicability of an RA claim for each project is discussed below.

Project A: New factory building
The new factory building will be constructed to undertake the manufacture of men's garments. Prior to this investment, SGSB manufactured only ladies' garments. Therefore, as the new facility will allow the company to diversify into the manufacturing of men's garments, the project can avail of the RA under the 'diversification' category. Therefore, SGSB will be eligible to claim RA in respect of the qualifying capital expenditure incurred in respect of the qualifying project of diversification.

In the case of a building, the qualifying building expenditure is said to be incurred when the building is completed. For plant and machinery, the qualifying expenditure is regarded as having been incurred when the asset is capable of being used in the business. In addition, where an asset is acquired under a hire purchase agreement, the qualifying expenditure includes only the capital portion of instalments **paid** during the basis period. The incentive will be given for each YA in which qualifying expenditure is incurred, provided it does not exceed the RA period.

Factory building
For the purpose of RA, 'factory' refers to a building used for the purpose of a qualifying project, i.e. in this case the diversification to manufacture men's garments. As the building is to be completed in the financial year ending 30 September 2018, RA may be claimed in YA 2018 on RM2,500,000.

Machinery
As the machinery will be put into use in the financial year ending 30 September 2018, SGSB will also be eligible to claim RA on the machinery in YA 2018. However, the machinery is acquired under a hire purchase arrangement with effect from 1 October 2017, therefore, the RA can only be claimed based on the capital portion of the instalments paid during the basis period for the relevant YA. The capital portion of the instalments to be made in YA 2018 will be RM1,100,000 [RM200,000 + (12 x RM75,000)]. SGSB will not be eligible to claim the balance of the instalment payments of RM900,000 (RM1·8 million – RM900,000) as this amount will be incurred outside the RA incentive period, i.e. after YA 2018.

Project B: Yarn weaving machine
The yarn weaving machine will be purchased to allow SGSB to undertake the production of fabrics which currently form the raw materials for its garment-manufacturing activities. With the acquisition of this machine, SGSB can reduce its fabrics cost by 50% as the fabrics can be produced in-house. The question is whether this manufacture of fabrics can be regarded as a diversification project from SGSB's existing garment manufacturing activity.

The production of fabrics is regarded as a backward integration activity, i.e. the production of components or raw materials used in an existing end product of the company. The tax authorities have taken the view that backward integration is not eligible as a diversification project and, therefore, no RA may be claimed on the yarn weaving machine.

(iii) Income tax deductibility of certain expenditure

During the financial year ending 30 September 2017, SGSB has incurred certain expenditure relating to the chimney construction, light bulbs and a compensation payment to a neighbouring company, TMSB. The tax treatment of these expenditure items is discussed below.

Chimney construction
The old chimney of the existing factory building was damaged and needed to be rebuilt. However, as SGSB will also be undertaking the yarn weaving activities in the building, the chimney had to be heightened to meet the environmental requirements.

A repair involves the replacement of a subsidiary or component part of the whole asset (the entirety) whereas a renewal refers to the replacement of a substantial part of the whole asset. Generally, repair and renewal expenses, which do not materially add to the value nor appreciably prolong the life of an asset, but merely keep it in good and efficient operating condition, are tax deductible. If the replacement of the asset is of its entirety, then it will not be deductible, as it does not connote repair. Only the replacement of a part of the asset will rank for deduction.

In this particular case, as the chimney forms part of the larger factory building, it can be said that the chimney forms part of a larger asset. However, as there is an improvement being made to the chimney to cater for the yarn weaving activities, the replacement of the chimney will be regarded as capital in nature and so will not rank for a tax deduction. It follows that the chimney cost is eligible for industrial building allowance (IBA).

Additionally, it should be noted that, based on established case law, even the cost of the notional repairs (i.e. the repair expenses which would have been incurred if the chimney had not been heightened) is not allowed for tax deduction. Hence, the notional repair amount of RM200,000 cannot qualify for tax deduction.

Light bulbs
The cost of replacing the light bulbs is allowed as a tax deductible expense as it is a repair and renewal cost.

Compensation payment to TMSB
TMSB proposed to venture into the manufacture of cotton garments. In order to stop this development and the resulting competition, SGSB made a compensation payment to TMSB of RM300,000. As part of the settlement, it has been agreed that TMSB will refer its orders for cotton garments to SGSB, while in return SGSB will refer its orders for silk garments to TMSB.

In determining the tax deductibility of the expenditure, a distinction must be made in regard to compensation relating to the profit yielding structure of the business as opposed to the process by which the entity operates. Based on established case law, it has been held that compensation paid to buy out competition which relates to the profit yielding structure of the company is a capital payment and, therefore, not tax deductible.

In this particular case, if the RM300,000 paid to TMSB is to pre-empt a potential competitor in the production of cotton garments, the amount is capital in nature and so not tax deductible.

On the other hand, if the RM300,000 is to induce TMSB to enter into a mutual cooperation trade agreement, under which each party will refer the cotton or silk orders to the respective producer, then it is made for a trade pact which directly relates to the profit-making machinery of SGSB. Hence, it may be argued that the amount is revenue in nature and is duly deductible.

On balance, we are of the view that the payment was made to buy out a potential competitor or to induce a potential competitor to mutually cooperate instead, and hence is capital in nature.

[**Marking note:** *Marks should be awarded for a contrary conclusion to the extent that it is reasonably and cogently argued.*]

(iv) Income tax deductibility on the input tax incurred by the company

Chimney construction
The input tax incurred on the chimney construction has been claimed as a credit in SGSB's goods and services tax (GST) return. Therefore, the input tax is not a cost to the business and the issue of income tax deductibility is not relevant.

Light bulbs
SGSB did not claim the input tax on the light bulbs in its GST returns on the basis that the tax invoice was not issued in the name of the company. As such, the input tax becomes a cost to the business. Under the income tax legislation, it is provided that GST expenses are to be disallowed for income tax deduction in respect of GST input tax paid or to be paid by the company if the company is entitled under the GST legislation to a credit of the amount as input tax.

Therefore, in determining the income tax deductibility of the input tax, it is necessary first to establish whether SGSB is entitled to claim a credit on the input tax under the GST legislation. In the present case, SGSB should be entitled to claim an input tax credit in its GST return as the light bulbs expense was incurred for the furtherance of the company's business. But, as the tax invoice for the expense was not issued in the name of SGSB, this has invalidated the claim of an input tax credit. However, SGSB will still be able to claim the input tax if it gets the supplier to re-issue the tax invoice under its own name.

On this basis, as SGSB would be entitled to a credit for the input tax in its GST return had a valid tax invoice been obtained, the GST input tax should not be allowed as an income tax deduction.

(v) GST implications of the compensation payment

In order for GST to be applicable, the compensation payment must be made in relation to a supply under the GST legislation. Essentially, in order for a supply to occur, the following should be present:

– there must be a transfer of ownership of goods (in the case of a supply of goods) or be for something which is done or to be done including the granting, assignment or surrender of any right or the making available of any facility or advantage (for a supply of services); and

– it must involve a consideration.

On the basis that TMSB is prevented from venturing into cotton garment manufacturing, this involves the surrender of certain rights and, therefore, would be regarded as a supply of services. The compensation payment of RM300,000 represents the consideration for the transaction, so should be subject to GST at 6%.

(vi) To illustrate the tax impact of the above items on the company's tax return, computations of SGSB's total income for tax purposes for each of the YAs 2017 and YA 2018 are set out in the appendix attached herewith.

------- End of report ---------

Appendix

Serene Garment Sdn Bhd
Computation of total income for the year of assessment (YA) 2017 and YA 2018

	YA 2017		YA 2018	
	RM'000	RM'000	RM'000	RM'000
Adjusted loss		(500)		
Add: Chimney construction (excluding GST)		500		
Add: Light bulbs		nil		
Add: GST input tax – light bulbs		9		
Add: Compensation to neighbouring company		300		
Adjusted income (recomputed)		309		5,000
Less: Capital allowance				
As calculated	2,000		2,000	
IBA on chimney ((10% + 3%) x RM500,000)	65			
(3% x RM500,000)			15	
Claimed	(309)	(309)		
Carried forward	1,756		1,756	
				(3,771)
Statutory income		nil		1,229
Less: Reinvestment allowance (working)		(nil)		(860)
Total income				369

Working: Reinvestment allowance

	YA 2017	YA 2018
	RM'000	RM'000
Eligible capital expenditure		
Factory building	0	2,500
Machinery	–	1,100
Yarn weaving machine (not eligible)	nil	–
	nil	3,600
Reinvestment allowance at 60%		2,160
Utilisation of claim (restricted to 70% of statutory income)		(860)
Reinvestment allowance carried forward		1,300

2 Lamsah Berhad (LB)

(a) Investment holding company

Under the tax legislation, a company is regarded as an investment holding company (IHC) if the following two conditions are met:

(i) the company's activities consist mainly in the holding of investments (the 'qualitative' test); and

(ii) not less than 80% of its gross income (whether exempt or not) is derived from the holding of investments (the 'quantitative' test).

Both conditions must be met.

Applying the two conditions to LB:

(i) Qualitative test – the principal activity of LB is that of investment holding. The provision of management services to its subsidiaries is merely to complement this investment holding activity by giving support to the group. As LB derives most of its income from its investments, its activities consist mainly in the holding of investments.

(ii) Quantitative test – based on the information provided for the financial year ended 31 March 2017, LB's investment income constitutes 90% (i.e. more than 80%) of its gross income, computed as follows:

	RM'000
Investment income	
Dividend from local subsidiaries	3,000
Dividend from foreign subsidiaries	1,400
Interest from local subsidiaries	4,600
	9,000
Non-investment income	
Fees for management services from subsidiaries	1,000
	10,000
Percentage of investment income over total income	90%

Therefore, LB meets both IHC conditions and will be treated as an IHC for tax purposes.

As LB is a listed company and an IHC, any income it derives from the holding of investments is deemed as a business source. Each source of income has to be assessed as a separate business source. In this respect, the dividend and interest income derived by the company are deemed as separate business sources.

In ascertaining the adjusted income and statutory income of the deemed business sources, the special treatment is applied as follows:

(1) The amount of allowable deduction for expenses is restricted to the amount of gross income from that source for that year of assessment. Any excess of those expenses is to be disregarded (cannot be absorbed by any other source of income or carried forward to subsequent years of assessment).

(2) Capital allowances on qualifying capital expenditure incurred by the company are allowed to be deducted in arriving at the statutory business income of the respective sources but the claim will be restricted to the amount of adjusted income from that source. If there is no adjusted income or the adjusted income is not sufficient to absorb those allowances, any excess of allowances cannot be carried forward to subsequent years of assessment.

The above special treatment is not applicable to the genuine business income of a listed IHC (e.g. fees for the provision of management services) where the normal tax rules will apply. For genuine business income, where there is an excess of expenditure over income, the excess would constitute a tax loss available to be deducted against other income. Similarly, any excess of capital allowances over the adjusted income can be carried forward to subsequent years of assessment.

(b) Total income for the year of assessment (YA) 2017

	Dividend RM'000	Interest RM'000	Management service fees RM'000
Dividend income			
– Local subsidiaries	nil		
– Foreign subsidiaries	nil		
Gain on disposal of investment	nil		
Interest income from local subsidiaries		4,600	
Management service fees			1,000
Less: Direct expenses			
Staff costs			(200)
Office overheads			(100)
Less: Interest expenses (W1)	nil	(275)	nil
Less: Deductible common expenses (W2 and W3)	nil	(460)	(100)
Adjusted income	nil	3,865	600
Less: Capital allowances (W4)	(nil)	(92)	(20)
Statutory income	nil	3,773	580
Aggregate statutory income from businesses/aggregate income (3,773 + 580)			4,353
Less: Unabsorbed tax losses brought forward			(100)
Total income			4,253

Working 1: Allocation of interest expenses based on investment balance

	Dividend RM'000	Interest RM'000
Investment in local subsidiaries	80,000	
Investment in foreign subsidiaries (excluded)	0	
Amount owing by local subsidiaries (interest bearing)		110,000
Amount owing by local subsidiaries (non-interest bearing)		10,000
	80,000	120,000
Allocation of common interest expenses (600 – 100 = 500) based on investment balances	200	300
Add: Interest on loan for foreign subsidiaries	100	
Less: Interest allocated to non-interest bearing loan (10,000/120,000 x 300)		(25)
Deductible interest expenses	300	275

[**Tutorial note:** *The investment in foreign subsidiaries is excluded as it is financed specifically by a Labuan loan.*]

Working 2: Allocation percentage based on gross income for common expenses and capital allowance

	Dividend RM'000	Interest RM'000	Management service fees RM'000
Dividend income			
– Local subsidiaries	3,000		
– Foreign subsidiaries	1,400		
Interest income from local subsidiaries		4,600	
Management service fee income			1,000
	4,400	4,600	1,000
Percentage of allocation	44%	46%	10%

Working 3: Allocation of common expenses

	RM'000
Total amount of common expenses	1,000
Allocation of deductible common expenses	
Dividend income (44%)	440
Interest income (46%)	460
Management service fee income (10%)	100
	1,000

Working 4: Allocation of common capital allowance

	RM'000
Common capital allowance	200
Allocation of capital allowance	
Dividend income (44%)	88
Interest income (46%)	92
Management service fee income (10%)	20
	200

(c) Share buyback

Initial share purchase

The purchase by LB of its own shares from the stock exchange market represents a capital transaction and, therefore, the amount incurred would not be allowed as a tax deduction.

Application of shares to fulfil the share award scheme

A special tax deduction is accorded [under s.34D(1)] for any expenses incurred by a company in acquiring treasury shares to fulfil its obligations under an employee share scheme. The tax deduction is given in ascertaining the adjusted income of the company from a business source for the basis period for the year of assessment.

Where the shares are applied to fulfil the obligations of a share award scheme, the company will be able to claim a tax deduction for the cost of acquiring such treasury shares. Although the treasury shares were acquired by LB in YA 2017, the tax deduction will only be afforded to the company when the share award is given to the employees in YA 2018.

Disposal of shares on the stock exchange market

When LB subsequently disposes of its own shares on the stock exchange market, the company could make either a gain or a loss. As the share buyback exercise is undertaken to improve the share price of the company, rather than a transaction entered into to make profits for the company, it cannot be said that the disposal of the shares will be regarded as a trading transaction. The dealing in its own shares relates to the capital structure of the company. Therefore in this case, any gains or losses arising from the disposal should neither be taxable nor tax deductible.

3 ForinCo

(a) Permanent establishment (PE)

2017

During the year 2017, ForinCo will effectively be carrying out a feasibility study, establishing business contacts, collecting local market information and building visibility for its products in the Malaysian market. Although the marketing manager will be stationed in Malaysia for a full five months, he will not solicit or make sales nor render any services to third parties. There is therefore no fixed base in Malaysia through which integral activities are carried out.

The activities carried out by the marketing manager on behalf of ForinCo are all to determine whether it is viable to do business in Malaysia. They are therefore preparatory and auxiliary in nature. Hence, ForinCo is not likely to have a PE in Malaysia in 2017.

2018

Assuming a positive feasibility report, ForinCo will proceed to task the marketing manager to establish a sales team, enter into contracts and maintain sufficient inventory in Malaysia to fulfil orders. These are integral and principal activities of a trading business. Therefore, ForinCo is likely to have a PE in Malaysia in 2018.

(b) Branch versus subsidiary

The comparative tax treatment accorded to a branch in Malaysia vis-à-vis a subsidiary incorporated in Malaysia is tabulated as follows:

	Branch	Subsidiary
Deductibility of business expenses	Business expenses incurred wholly and exclusively for the production of gross income (and not prohibited) attributable to the branch are tax deductible.	Business expenses incurred wholly and exclusively for the production of gross income (and not prohibited) of the subsidiary are tax deductible.
Claiming capital allowances (CA) on assets, including small-value assets	All assets, to the extent they constitute qualifying plant and machinery, and are used in the business attributable to the branch in Malaysia, are eligible for CA.	All assets, to the extent they constitute qualifying plant and machinery, and are used in the business of the subsidiary in Malaysia, are eligible for CA.
	As regards small-value assets, a branch, being a non-resident company, will be able to claim the 100% CA on small value assets up to a total value of only RM13,000 in a year of assessment.	As regards small-value assets, the Malaysian subsidiary will be incorporated and resident in Malaysia as well as a small and medium (share capital less than RM2·5 million) company (SME), and so will qualify for the 100% CA in respect of an unlimited total value of small value assets in a year of assessment.
Withholding tax on interest and technical fees paid to ForinCo	As a branch paying interest to its head office which is the same entity, withholding tax is not applicable as the law [s.109] envisages the payer and recipient as two separate persons.	The Malaysian subsidiary and ForinCo are two separate and distinct entities. Therefore, the payment of interest to ForinCo, a non-resident parent company, will attract withholding tax [s.109].
	The payment of technical fees by the branch to its head office, a non-resident, will attract withholding tax because of the different phrasing of the provision [ss.4A and 109B].	The payment of technical fees to ForinCo, a non-resident company, will also attract withholding tax [s.109B].
Applicable tax rates	The Malaysian branch is part of ForinCo, a non-resident company. The chargeable income of the branch will all be subject to the standard rate of tax of 24%.	The Malaysian subsidiary will have a paid up share capital of RM1 million. It is 100%-owned by ForinCo which has a paid up share capital of RM2 million. Hence, the Malaysian subsidiary qualifies as a SME company and will be subject to tax at 19% on the first RM500,000 and any excess at 24%.

	Branch	Subsidiary
Repatriation or distribution of profit	As the Malaysian branch is part of ForinCo, any profits made by the branch intrinsically belong to ForinCo: there is no need to invoke the process of dividend distribution. The branch can freely repatriate the profits to Ruritania as and when it sees fit. There is no restriction on the amount which can be repatriated, to the extent that the prevailing Malaysian foreign exchange rules are complied with.	As a separate and distinct entity from its parent company, the Malaysian subsidiary of ForinCo can only distribute its profits to its parent through a dividend, subject to the availability of retained earnings. The dividend is deemed to be derived from Malaysia. In Malaysia, there is no dividend withholding tax, so the distribution of dividend will not be subject to withholding tax.

4 (a) Mr Balik Kampong (BK)

(i) Commencement of pottery business

When BK rented the warehouse building in November 2016, and then renovated it and fitted it out over the ensuing five to six months, he was preparing to start the business.

On 1 May 2017, when the raw materials arrived and production began, the business of producing fine pottery commenced. The commencement of business had already occurred when the first shipment of finished goods was made. Therefore, the business commenced on 1 May 2017.

As an individual, pursuant to the law [s.21], BK's basis period is the basis year, i.e. the calendar year. This means that the first basis period for BK's business is 1 May 2017 to 31 December 2017.

(ii) Tax computation for the year of assessment (YA) 2017

	RM	RM	Note
Pottery business			
Turnover		1,000,000	
Less: Business expenses		(793,000)	
Adjusted income		207,000	
Less: Capital allowances:			
Plant and machinery			
RM200,000 x (20% + 14%)	68,000		(1)
Industrial building allowance			
RM300,000 x (10% + 3%)	39,000		(2)
		(107,000)	
Statutory income		100,000	
Rental income from overseas property		nil	(3)
Singapore dividend		nil	(3)
Malaysian dividend		nil	(4)
Aggregate income		100,000	

Notes:

(1) BK incurred capital expenditure on plant and machinery used in his business of manufacturing fine pottery which commenced in YA 2017. Therefore, he is deemed to incur the qualifying expenditure on 1 May 2017 when the business commenced and so qualifies for capital allowances in YA 2017.

(2) Although BK does not own the warehouse building, he did expend RM300,000 on renovations in order to render the building suitable for manufacturing. Therefore, he has a relevant interest in respect of the renovation cost of RM300,000. Owing to the fact that the building was used to manufacture fine pottery, it is a factory and thus constitutes an industrial building (IB). Therefore, BK is eligible to claim industrial building allowance (IBA) in respect of the renovation cost in YA 2017 when the renovations were completed and the business commenced.

(3) Both the rental income and the Singapore dividend are foreign-sourced income, and so tax exempt.

(4) The Malaysian dividend is a single-tier dividend, and so tax exempt in the shareholder's hands.

(iii) Madam Rich

Prior to the renovations carried out by BK, the warehouse was merely a storage building, which did not qualify as an IB. After the renovations, it was used as an IB by BK, Madam Rich's tenant. Pursuant to the law [paragraph 60, Schedule 3], Madam Rich, as the owner of a building used as an IB by her tenant, is eligible to claim IBA against her rental income from the letting of the warehouse to BK in YA 2017 and subsequent years.

The qualifying building expenditure (QBE) will be the original cost of construction or purchase incurred by Madam Rich and the residual expenditure will be the QBE less any IBA claimed and/or any notional allowances written off up to and including YA 2016.

(b) One Two Three Sdn Bhd (OTT)

The law on time bar [s.91] states that the Director General of Inland Revenue (DGIR) has up to five years after the expiration of a year of assessment to raise any assessment or additional assessment for that year of assessment (YA).

The time bar does not apply if it appears to the DGIR that there is fraud, wilful default or negligence involved.

With reference to OTT, the DGIR does not allege fraud, wilful default or negligence; the additional assessments arose out of a disallowance of director's remuneration being deemed excessive and the return deemed 'incorrect'. The tax audit process does not defer or extend the five-year period.

YA 2010 – For YA 2010, the statutory time bar of five years ended on 31 December 2015. The additional assessment was raised on 18 May 2017. Therefore, the additional assessment for YA 2010 was raised out of time and is time-barred.

YA 2011 – For YA 2011, the statutory time bar of five years ended on 31 December 2016. The additional assessment was raised on 18 May 2017. Therefore, the additional assessment for YA 2011 was raised out of time and is time-barred.

YA 2012 – For YA 2012, the statutory time bar of five years ended on 31 December 2017. The additional assessment was raised on 18 May 2017. Therefore, the additional assessment for YA 2012 was raised within the five-year period and is therefore a valid assessment.

YA 2013 – For YA 2013, the statutory time bar of five years ended on 31 December 2018. The additional assessment was raised on 18 May 2017. Therefore, the additional assessment for YA 2013 was raised within the five-year period and is therefore a valid assessment.

5 DEF Sdn Bhd (DEF)

(a) Premium and annual rent

Premium
The premium of RM180,000 was paid by DEF to secure the 30-year lease. It was a one-off payment and its benefit extended over 30 years. DEF has thus obtained a right to occupy the land for 30 years. The payment has created an asset of enduring benefit. Hence, the payment is capital in nature and is not tax deductible in arriving at DEF's adjusted income in the year of assessment 2010.

Annual rent received in advance
The annual rent of RM36,000 is for the use of the land each year. This is a recurring expenditure and does not give rise to an asset of enduring benefit. Therefore, the annual rent is a revenue expense in nature and tax deductible in arriving at the adjusted income of DEF's trading business.

Additionally, the deductibility of the rental expense is also specifically provided for in the law [s.33(1)(b)]. However, as it was paid three years in advance, the same law [s.33(1)(b)] provides that only the rent payable for that period is deductible, i.e. only RM36,000 will be deductible in each year of assessment.

(b) Sub-lease

The 30-year lease from Mr Pemilik secured a right for DEF over land situated in Malaysia. The lease therefore became a chargeable asset; DEF acquired this chargeable asset on 1 May 2010.

By sub-leasing the land to XYZ Sdn Bhd, DEF has effectively disposed of the said chargeable asset, namely the lease [paragraph 25, Schedule 2, RPGT Act].

DEF has therefore disposed of the lease asset on 1 May 2017 and the premium of RM295,000 constitutes the disposal consideration.

(c) Sub-lease – Real property gains tax (RPGT computation)

		RM
Disposal consideration/price		295,000
Less: Acquisition consideration/price:		
$\frac{\text{30 years – 7 years (1 May 2010 to 1 May 2017)}}{\text{30 years}}$	x 180,000	(138,000)
Chargeable gain		157,000
Less: Allowable loss (shophouse)		(77,000)
		80,000
Disposal date: 1 May 2017		
Acquisition date: 1 May 2010		
Disposal in the eighth year		
RPGT charged at 5%		4,000

Although the disposal of the shophouse occurred after the disposal of the lease, the loss of RM77,000 is allowable against the chargeable gain arising on the earlier transaction because the law [s.7(4), RPGT Act] provides that an allowable loss is deductible against the total chargeable gain of a person for the same year of assessment in which the disposal was made.

(d) Income tax assessability on Mr Pemilik

Premium

Mr Pemilik has relinquished the right to use his freehold land for the 30-year period. This was also the first and only time so far that he has granted a lease. The receipt of RM180,000 may therefore be argued to be capital in nature.

On the other hand, it may be argued that the RM180,000 represents one form of return from his investment in the freehold land. Hence, it may be argued that the RM180,000 lease premium is revenue in nature, and properly subject to income tax.

Annual rent received in advance

Annual rent for the use of land is intrinsically revenue in nature and should be subject to income tax. Pursuant to the law [s.27(1)], when rental income is received in advance, the entire sum is treated as gross income in the year of receipt. Therefore, the entire sum of three years' rent, i.e. RM108,000 (RM36,000 x 3), received in year 1 will be taxable on Mr Pemilik in year 1.

[Tutorial note: *Section 27 (1) reads: '... where gross income...consists of ...rent... and first becomes receivable in the relevant period, it shall when it has been received be treated as gross income of the relevant person for the relevant period.' This treatment of rent received in advance is demonstrated in paragraph 9 of Public Ruling 4 of 2011.*]

			Marks
1	**(i)**	**Eligibility for reinvestment allowance (RA)**	
		RA qualifying period conditions (0·5 x 2)	1
		Old RA period expired	0·5
		Special RA period	1
		Expiry of special RA	0·5
		Available	3
		Maximum	2
	(ii)	**Applicability of RA claim for each project**	
		New factory building:	
		– Qualifying project	1
		– Timing of building expenditure	1
		Machinery:	
		– Timing of machinery expenditure	1
		– Effect of HP arrangement	1
		Application to Project A expenditure:	
		– Factory building	0·5
		– Machinery	1·5
		Yarn weaving machine – backward integration, no claim	1 + 1
		Available	8
		Maximum	6
	(iii)	**Income tax deductibility**	
		Chimney construction:	
		– Repair v renewal; replacement in whole or in part	1 + 1
		– Chimney part of larger factory building	0·5
		– Improvement capital in nature, eligible for IBA	1 + 1
		Notional repairs issue	1
		Light bulbs	1
		Compensation:	
		– Profit yielding structure v process by which entity operates	1
		– Buying out competition is profit yielding structure, so capital	1 + 0·5
		– Mutual trade arrangement relates to operating process, so revenue	1 + 0·5
		– Conclusion	0·5
		Available	11
		Maximum	9
	(iv)	**Income tax deductibility – input tax**	
		Chimney construction:	
		– Claimed in GST return so not a cost to business	1
		– Deductibility for income tax not relevant	1
		Light bulbs:	
		– Cost to the business/business expense if no GST claim	0·5
		– No valid tax invoice invalidates GST claim	0·5
		– But still entitled if valid invoice obtained	0·5
		– Conclusion: not tax deductible	1
		Available	4·5
		Maximum	4
	(v)	**GST treatment of compensation**	
		Something done	1
		Consideration	0·5
		Application – supply of services	1
		GST chargeable	0·5
			3

		Marks
(vi) Tax computation		
YA 2017		
– Tax adjustments to arrive at adjusted income (0·5 x 4)		2
– CA – correct stage, IBA on chimney, CA c/f		0·5 + 0·5 + 0·5
YA 2018		
– CA – IBA, CA b/f		0·5 + 0·5
– RA computation – factory, machinery, yarn machine, 60%		0·5 + 0·5 + 1 + 0·5
– 70% restriction, RA c/f		0·5 + 0·5
– Total income		0·5
	Available	8·5
	Maximum	7

Professional marks

Format and presentation of the report	1
Clarity and effectiveness of communication including logical flow	2
Appropriate use of appendix	1
	4
	35

			Marks
2	(a)	**Status of investment holding company**	
		Definition of IHC – two conditions	1 + 1
		Application:	
		– Qualitative test	1
		– Quantitative 80% test	1
		Impact of being an IHC:	
		– Deemed business source, assessed separately for each source	1 + 0·5
		– Treatment of expenses	1
		– Treatment of CAs	1
		– Treatment of genuine business source income	1
		Available	8·5
		Maximum	7
	(b)	**Tax computation for YA 2017**	
		Treatment of each gross income (0·5 x 5)	2·5
		Treatment of direct expenses: Management fees	0·5 + 0·5
		Treatment of interest expenses:	
		– Allocation based on investment balances	1 + 1
		– Interest on specific loan for foreign investment	0·5
		– Interest allocated to non-interest bearing loan	1
		Allocation of common expenses based on gross income	1 + 0·5 + 0·5
		Allocation of capital allowance based on gross income	0·5 + 0·5 + 0·5
		Disregarded expenses for dividend income	1
		Treatment of excess of expenditure over income in prior year:	
		– Interest	1
		– Management fee	1
		Available	13·5
		Maximum	12
	(c)	**Share buyback**	
		Initial buyback – no deduction	1
		Share award scheme	
		– Tax deduction	1
		– Quantum of deduction	1
		– Timing	1
		Disposal of shares	
		– Not undertaken to make profits	1
		– Relates to capital structure	1
		– Not taxable/deductible	1
		Available	7
		Maximum	6
			25

				Marks
3	(a)	**Permanent establishment (PE)**		
		2017		
		– No PE, reasons		1 + 1
		2018		
		– PE arises, reasons		1 + 1
				4
	(b)	**Subsidiary versus branch**		
		Deductibility of business expenses: attributable to branch, subsidiary		1 + 0·5
		CA claim: assets used in business: branch, subsidiary		0·5 + 0·5
		small-value assets: branch limited amount		1 + 1
		subsidiary no limit, reason		1 + 0·5
		Withholding tax:		
		Branch: interest, reasons		1 + 0·5
		technical fees		1
		Subsidiary: interest, reason		1 + 0·5
		technical fees		0·5
		Tax rates: branch – rate, reason		1 + 0·5
		subsidiary – SME, reason, rates		1 + 1 + 0·5
		Repatriation/distribution of profits:		
		Branch		1·5
		Subsidiary		1 + 1
			Available	18
			Maximum	16
				20

				Marks
4	**(a)**	**(i)**	**Commencement of business**	
			Rent of premises, renovations, fitting out – all preparatory, not commenced	1 + 0·5
			Raw materials arrived – production began, commenced	1 + 0·5
			First shipment of goods – already commenced	0·5
			Basis period:	
			– Individual basis period = calendar year	1
			– YA 2017, 1 May to 31 December 2017	1
			Available	5·5
			Maximum	5
		(ii)	**Computation of aggregate income**	
			Adjusted income	0·5
			CA – P&M, explanation	0·5 + 1
			IBA, explanation	0·5 + 1 + 1
			Statutory income	0·5
			Rental income, exempt, reason	0·5 + 0·5
			Singapore dividend, exempt, reason	0·5 + 0·5
			Malaysian dividend, exempt, reason	0·5 + 0·5
				8
		(iii)	**Madam Rich**	
			Prior to renovation storage only no claim	1
			Post renovation used as IB by tenant	1
			Claim for IBA, reason	1
			QBE/residual QBE	1
			Available	4
			Maximum	3
	(b)		**Time bar**	
			Time bar explained	1 + 1
			Application to OTT:	
			– No fraud alleged, so five-year limit	0·5
			– YA 2010	1
			– YA 2011	0·5
			– YA 2012	0·5
			– YA 2013	0·5
			Available	5
			Maximum	4
				20

			Marks
5	**(a)**	**Premium and annual rent**	
		Premium:	
		– Capital in nature, reason, not deductible	0·5 + 1 + 0·5
		Annual rent received in advance:	
		– Revenue in nature, reason, deductible	0·5 + 1 + 0·5
		– Received in advance, treatment, reason	1 + 0·5
		Available	5·5
		Maximum	5
	(b)	**Sub-lease – RPGT treatment**	
		Lease is chargeable asset, reason	1 + 1
		Sub-lease is a disposal of lease	1
		Disposal consideration	0·5
		Available	3·5
		Maximum	3
	(c)	**Sub-lease, RPGT computation**	
		Disposal consideration/price	0·5
		Acquisition price (0·5 x 4)	2
		Chargeable gain	0·5
		Allowable loss – allowed at correct stage	1
		– explanation	1·5
		Duration of holding	1
		RPGT rate	0·5
			7
	(d)	**Premium and annual rent received**	
		Premium:	
		– Capital in nature, reason	1 + 0·5
		– Revenue in nature, reason	1 + 0·5
		Annual rent in advance:	
		– Rent is revenue in nature	1
		– Treatment of rent received in advance, taxable in year of receipt, reason	1 + 1
		Available	6
		Maximum	5
			20

Examiner’s report
P6 (MYS) Advanced Taxation
June 2017

ACCA

General Comments

The examination consisted of two sections. Section A contained Q1 for 35 marks and Q2 for 25 marks, both questions being compulsory. Section B contained three questions of 20 marks each, from which candidates had to answer two questions.

The vast majority of candidates attempted all four questions, and there was little evidence of time pressure. Where questions were left unanswered by candidates, this appeared to be due to a lack of knowledge or poor exam technique, as opposed to time pressure.

Specific Comments

Question One

This 35-mark question was based on a garment manufacturer undertaking projects of diversification and backward integration. It tested candidates’ knowledge of the reinvestment allowance (RA), the capital versus revenue issue of replacement of parts of assets, compensation payment, income tax deductibility of input tax, GST, and tax computation.

Parts (i) and (ii) together for eight marks required candidates to determine the company's eligibility for RA and whether Projects A and B constituted qualifying projects and the timing of the claim. Many candidates wrote at length about all they knew about RA: the eligibility requisites, set off against 70% and credit to exempt account and carry forward of unabsorbed RA. They overlooked the timing aspect, i.e.

- that the company could enjoy RA only for 15 years from YA 2001,
- that there is an extension of three years,
- that the capital expenditure on the factory is deemed incurred only on completion, and
- that for machinery on hire purchase, only the capital portion paid up qualified for RA.

While still on RA, many candidates also did not correctly identify Project A as "diversification" and Project B as "backward integration" despite the facts being quite clear about diversifying into men's garments and going upstream to produce the raw materials. Candidates tended to think only of "expansion".

Part (iii) for nine marks tested very fundamental tax principles of replacement of part or whole, whether there was enhancement to render it as capital in nature, and whether a compensation payment to a would-be competitor is capital or revenue in nature. This was generally well-answered.

Part (iv) required candidates to explain whether input tax borne on the chimney construction and light bulbs was deductible for tax purposes. Part (v) asked whether the compensation payment to the competitor was subject to GST. Candidates did not appear to have grasped GST well.

Overall the performance on the question was not satisfactory.

Question Two

Parts (a) and (b) together tested all aspects of the listed investment holding company (IHC).

While the tax status of the company was well understood, the tax computation required in part (b) was not well done.

The aspects which created difficulty were:

- That as the investment income from dividend and interest was to be treated as separate business sources and therefore the common expenses, interest and capital allowances were also to be separately attributed,
- That management fees were to be treated as a genuine business, and not as a source under section 4(f),
- That the loss from the interest source was not allowable, while the loss from the genuine business source was allowable against statutory income from all businesses (including deemed business).

Part (c) for six marks dealt with a company buying back its own shares from the open market to meet its ESOS obligations. Many candidates performed well, regarding the capital nature of its initial buy-back and subsequent sell-back.

However, as regards the application of the treasury shares to meet ESOS obligations, many candidates did not bring out the point that the cost of such shares was deductible because of specific legislation. Instead, they wrote about the tax treatment of such shares in the hands of the employees, which was not relevant in this instance.

Question Three

This 20-mark question set the scenario of a foreign enterprise contemplating doing business in Malaysia and tested the topics of permanent establishments (PE), and the comparative tax treatment of a branch and a locally-incorporated company.

Part (a) on whether there was a PE in Malaysia for two years of assessment was well responded to, and candidates demonstrated they had a clear understanding of the PE concept.

Part (b) regarding the comparative treatment of a branch and a subsidiary was really a test of fundamental principles of

- tax deductibility of business expenses,
- eligibility for capital allowance in general and for small value assets in particular,
- application of withholding tax,
- tax rates, and
- the tax implications of the distribution of profits.

This part, which carried 16 marks, was generally well answered.

Question Four

Part (a) of this 20-mark question related to an individual starting up a business while also deriving income from overseas. It tested the determination of commencement of business, basis period of an individual, eligibility for industrial building allowance (IBA) by owner and tenant, and the scope of charge.

Out of the above topics only the commencement of business was well attempted. Many candidates were not aware that individuals can only have a basis period made up of the calendar year. They were also not aware of the fact of the tenant having a relevant interest over a rented building by virtue of the capital expenditure incurred by him. They were also equally unaware of the eligibility for IBA by the owner of a building if the building was used as an industrial building by her tenant.

Part (b) tested the statutory time bar in the context of additional assessments issued after a tax audit.

Most candidates performed satisfactorily. One point was omitted though: that the time bar did not apply if there was fraud, wilful default or negligence. Some candidates still alluded to the defunct "7 years", rather than the current 5 years time bar.

Question Five

This 20-mark question tested the tax treatment of premium and rental in relation to a lease of land, from the perspective of the land owner and the lessee. It also tested the real property gains tax (RPGT) treatment of a sub-lease.

Part (a) for five marks required an appreciation of the payment of a premium to secure a right to use the land over a period and the payment of annual rent for the use of the land. It boiled down to the capital versus revenue issue.

Parts (b) and (c) related to the treatment of the sub-lease and the computation of RPGT. Many candidates did not take account of the lapsed period of the lease to correctly determine the acquisition price of the lease, but most were able to correctly set off the allowable loss.

Part (d) dealt with the tax treatment of the premium and the annual rent from the recipient's perspective. Apart from the issue of capital versus revenue, which was not clearly argued by many candidates, the issue of rental received in advance was adequately responded to.

Examiner's report

P6 Advanced Taxation (MYS)

September 2017

General Comments

The examination consisted of two sections. Section A contained Q1 for 35 marks and Q2 for 25 marks, both questions being compulsory. Section B contained three questions of 20 marks each, from which candidates had to answer two questions.

Most candidates attempted all four questions and there was little evidence of time pressure. Where parts of questions were left unanswered by candidates, this appeared to be due to insufficient knowledge or poor exam technique, as opposed to time pressure.

Candidates preparing for this paper must ensure that they have a comprehensive grasp of fundamental tax principles because this paper requires efficient application of said principles to practical scenarios/situations. In many cases, candidates have not demonstrated good knowledge or application of these fundamentals.

Candidates are again urged to read the requirements carefully and calmly, and tailor their answers to what has been asked, rather than writing everything they know about the topic being examined.

Specific Comments

Question One

This 35 mark question covered a range of topics, including group relief, the impact of related party transactions on income tax and GST, and stamp duty.

The information provided in the question on group relief confirmed eligibility for the relief and also identified the group entities that qualified for the relief. In part (a)(i) candidates were then tested on the procedural requirements and mechanism of group relief. The majority of candidates wrote at length about the eligibility conditions and neglected the actual requirements in this part. Valuable time was thus taken up, earning no marks.

The computations in part(a)(ii) to demonstrate how the group relief is calculated were generally well done. Not as well done was part (a)(iii) on the consequences of providing incorrect information in relation to a group relief claim.

In part (b), transfer pricing issues were generally well understood in the context of related party transactions, although some candidates did not realise that a discount which is also available to third parties would render it a non-issue.

The GST requirement in part (b)(ii) was satisfactorily responded to. Most candidates missed the mixed supplier aspect while some candidates did not comment on the adoption of market value where the supply is between connected persons.

With reference to part (c) on stamp duty on the transfer of shares, while the applicable rate was generally known, the eligibility for relief was less well understood.

Question Two

Part (a) of this question dealt with the research and development (R&D) incentive and offered two options; Either carry out the R&D in-house with seconded personnel, or outsource to a university. The facts in the question indicated that only expenses were involved and no mention of capital expenditure was made. However, many candidates wrote everything they know about R&D incentives including pioneer status and investment tax allowance. Both of these topics were irrelevant as no capital expenditure was involved. Additionally, many candidates did not calculate the after-tax effect of each option.

Part (b) tested related-party financing, and required candidates to explain how and when interest income and interest expense would be taxable and deductible. Some candidates seemed unaware of the fact that there is specific tax treatment prescribed.

Part (c) tested the differences in the tax treatment of an employee and an independent consultant. This was generally well answered. It was noted that many candidates did not stipulate what should or should not be in the proposed service contract.

Question Three

This 20 mark question tested real property gains tax (RPGT), withdrawal of stock, and the application of a private advance ruling.

The RPGT aspects tested in part (a) were conditional contracts (whether the contract described was a conditional contract and the significance of being one) and enhancement costs. Surprisingly, it appears that both topics are not well understood by candidates.

In part (b)(i), the scenario provided facts which candidates were expected to use selectively to argue the case for or against a ‘withdrawal of stock’. This style of this question represents a useful practical skill: know the law, collate the facts of the case, then build a case "for" or "against". Some candidates did well in this.

Part(b)(ii) on private advance ruling was generally poorly answered. Candidates would do well to know this aspect as it is often encountered in professional practice.

Question Four

This question comprised two parts. Part (a) dealt with trust income and trust beneficiaries. The computation of chargeable income of the trust was very well answered. However, when it came to the tax treatment of the beneficiaries, many candidates did not read the requirement carefully enough. Instead of discussing how each beneficiary is subject to tax in respect of the amounts received from the trust, they discussed the deductibility of the said payments from the perspective of the trust.

Part(b) tested the pre-operational business expenditure under Schedule 4A of the Income Tax Act, and the basis of recognising advance business receipts.

Apart from stating the general principle of pre-operating expenditure being non-deductible, many candidates were not aware of the specific deduction for such pre-operating expenditure overseas. Similarly, many candidates did not know of the specific treatment of business income received in advance and its subsequent refund.

Question Five

Part (a) of his 20 mark question tested the tax treatment of a Labuan entity under the Labuan legislation and under the Income Tax Act. This was reasonably well answered.

Part (b) tested error and mistake relief and the right of appeal after a delay. While many candidates correctly said that the wrong casting of the income figure constituted an error, they did not know about the five year time limit for error and mistake relief. As for not claiming the tax incentive because of ignorance, some candidates went on to discuss the eligibility for the incentive and did not address the eligibility for error and mistake relief. Also, candidates tended to confuse the time lines under error and mistake relief with the statutory time bar for raising an assessment/additional assessment and irrelevantly made reference to the presence/absence of fraud and wilful default.

Applying for an extension of time to exercise the right of appeal appears to not be well-grasped by candidates. Understanding error and mistake relief and the pursuit of the right of appeal despite a delay is important to a tax consultant. Thus, candidates should be well-versed in these aspects.

Professional Level – Options Module

Advanced Taxation (Malaysia)

September/December 2017 – Sample Questions

Time allowed: 3 hours 15 minutes

This question paper is divided into two sections:

Section A – BOTH questions are compulsory and MUST be attempted

Section B – TWO questions ONLY to be attempted

Tax rates and allowances are on pages 2–4

Do NOT open this question paper until instructed by the supervisor.

This question paper must not be removed from the examination hall.

Paper P6 (MYS)

Think Ahead ACCA

The Association of Chartered Certified Accountants

SUPPLEMENTARY INSTRUCTIONS

1. You should assume that the tax rates and allowances shown below will continue to apply for the foreseeable future.
2. Calculations and workings should be made to the nearest RM.
3. All apportionments should be made to the nearest whole month.
4. All workings should be shown.

TAX RATES AND ALLOWANCES

The following tax rates, allowances and values are to be used in answering the questions.

Income tax rates

Resident individuals

Chargeable income			Rate	Cumulative tax
	RM	RM	%	RM
First	5,000	(0 – 5,000)	0	0
Next	15,000	(5,001 – 20,000)	1	150
Next	15,000	(20,001 – 35,000)	5	900
Next	15,000	(35,001 – 50,000)	10	2,400
Next	20,000	(50,001 – 70,000)	16	5,600
Next	30,000	(70,001 – 100,000)	21	11,900
Next	150,000	(100,001 – 250,000)	24	47,900
Next	150,000	(250,001 – 400,000)	24·5	84,650
Next	200,000	(400,001 – 600,000)	25	134,650
Next	400,000	(600,001 – 1,000,000)	26	238,650
Exceeding	1,000,000		28	

Resident company

Paid up ordinary share capital	First RM500,000	Excess over RM500,000
RM2,500,000 or less	18%	24%
More than RM2,500,000	24%	24%

Non-residents	
Company	24%
Individual	28%

Labuan entity – income from a Labuan trading activity	
All chargeable profits	3%

Trust body – resident or non-resident	
All chargeable income	24%

Personal reliefs and allowances

		RM
Self		9,000
Disabled self, additional		6,000
Medical expenses expended on parents	(maximum)	5,000
Medical expenses expended on self, spouse or child with serious disease, including up to RM500 for medical examination	(maximum)	6,000
Parental care	(each)	1,500
Basic supporting equipment for disabled self, spouse, child or parent	(maximum)	6,000
Study course fees for skills or qualifications	(maximum)	7,000
Lifestyle allowance	(maximum)	2,500
Spouse relief		4,000
Disabled spouse, additional		3,500
Child – basic rate	(each)	2,000
Child – higher rate	(each)	8,000
Disabled child	(each)	6,000
Disabled child, additional	(each)	8,000
Childcare (below six years old)	(each, maximum)	1,000
Breastfeeding equipment	(maximum)	1,000
Life insurance premiums and contributions to approved funds	(maximum)	6,000
Private retirement scheme contributions, deferred annuity premiums	(maximum)	3,000
Medical and/or education insurance premiums for self, spouse or child	(maximum)	3,000
Deposit for a child into the National Education Savings Scheme	(maximum)	6,000
Contribution to Social Security Organisation (SOCSO)	(maximum)	250

Rebates

Chargeable income not exceeding RM35,000	**RM**
Individual – basic rate	400
Individual entitled to a deduction in respect of a spouse or a former wife	800

Capital allowances

	Initial allowance (IA) Rate %	Annual allowance (AA) Rate %
Industrial buildings	10	3
Plant and machinery – general	20	14
Motor vehicles and heavy machinery	20	20
Office equipment, furniture and fittings	20	10
Agriculture allowance		
Buildings for the welfare of or as living accommodation for farm employees	Nil	20
Other buildings used in the business	Nil	10
All other qualifying agricultural expenditure	Nil	50

Real property gains tax

	Companies	Individuals – non-citizens and non-permanent residents	All others
	Rate %	Rate %	Rate %
Category of disposal			
Disposal within three years after the date of acquisition	30	30	30
Disposal in the fourth year after the date of acquisition	20	30	20
Disposal in the fifth year after the date of acquisition	15	30	15
Disposal in the sixth year after the date of acquisition or thereafter	5	5	0

Goods and services tax (GST)

Standard rate	6%

Stamp duty

Rates of duty under the First Schedule

Conveyance, assignment, transfer or absolute bill of sale

	Rate %
Sale of property	
For every RM100 or fractional part thereof:	
On the first RM100,000	1
On the next RM400,000	2
On the excess over RM500,000	3
Sale of company shares	
On every RM1,000 or fractional part thereof	0·3

Section A – BOTH questions are compulsory and MUST be attempted

1 You are a tax associate of Tax Firm. On 5 December 2017, you and your tax director met with Farihah Sam, the chief financial controller of Highway Networks Group Sdn Bhd (HNG). HNG is owned by a group of individual shareholders and is a holding company with two subsidiaries: East Highway Sdn Bhd (EH) and Garden Landscaping Sdn Bhd (GL). All of the group companies have a paid-up ordinary share capital of RM1 million and make up their accounts to 31 August annually.

Below are the notes taken from this client meeting.

Notes of meeting with HNG

– EH has a highway concession in Malaysia on a build-operate-transfer (BOT) basis and has been collecting tolls on the completed highway since 2000.

– In 2015, under a re-negotiated concession, EH built an additional lane to the highway for which the government awarded EH a grant of RM45 million, to be payable on completion of the additional lane.

– EH has provided details of its statement of profit or loss for the year ended 31 August 2017 as follows:

	Note	RM'000	RM'000
Toll revenue			82,000
Other income			
– Rental from retailers operating at rest areas	1		5,000
– Grant receivable	2		3,000
			90,000
Less: Expenditure			
Quit rent and assessment for rest areas		600	
Maintenance of rest areas		400	
Finance cost	4	15,000	
Other tax deductible expenses		34,000	(50,000)
Profit before taxation			40,000

Notes:

1. There are rest areas along the highway whose retail areas are let out to individual operators. EH actively manages and maintains the rest areas.
2. Following the opening of the additional lane, EH received the government grant of RM45 million on 15 February 2017. In accordance with prevailing financial reporting standards, the grant will be evenly recognised as income over 15 years.
3. Classified under the 'Road development expenditure account' were the following expenditure items incurred during the year ended 31 August 2017:

	RM
Additional lane	60 million
Toll booths	5 million
Resurfacing of existing roads	18 million

The applicable initial and annual allowance rates are 10% and 6% respectively.

4. The breakdown of the finance cost is as follows:

	RM'000
Term loan interest	12,000
Dividend on redeemable preference shares of RM100 million	5,000
	17,000
Fixed deposit interest income (requirement under the bank term loan facility)	(2,000)
	15,000

Notes of meeting with HNG (continued)

- Farihah would like Tax Firm to advise on the various tax issues based on the financial position of EH for the year of assessment (YA) 2017.
- Farihah explained that for the financial year ending 31 August 2018, in order to increase its revenue and as part of its highway beautification initiative, EH plans to diversify into the business of floriculture by planting orchids on the idle land along the highway. EH will deploy its existing workers in this proposed orchid-growing activity. The orchids produced will be mainly for export but any excess orchids will be sold at retail booths to be set up at the rest areas. The floriculture business is expected to be profitable immediately.
- GL is involved in the garden nursery business which is loss making (with unabsorbed capital allowances and tax losses).

Your tax director has sent you an email requesting you to prepare a report for the management of HNG, which addresses the following:

(i) The tax treatment of the following incomes of EH and their related expenses:

- the rental received from retailers operating at rest areas; and
- the government grant.

(ii) The tax treatment of the road development expenditure incurred by EH for the:

- construction of the additional lane;
- construction of toll booths; and
- resurfacing of existing roads.

(iii) An income tax computation for EH for YA 2017, prepared on the basis that the letting of the rest areas is part of the highway business, illustrating the impact of the tax treatment of the above expenditure items. Provide an explanation of the tax rate to be used in the computation.

(iv) The tax treatment of the proposed business of floriculture. You should consider both how the income will be taxed in EH and whether it would be advantageous from a tax point of view for this business to be carried out by GL (instead of EH).

Required:

Draft the report to the Highway Networks Group Berhad as instructed by your tax director.

The following marks are available:

(i) The tax treatment of the other incomes of East Highway Sdn Bhd (EH) and their related expenses. (6 marks)

(ii) The tax treatment of the highway development expenditure. (10 marks)

(iii) EH's income tax computation for the year of assessment 2017.

Note: Indicate with the word 'nil' any item which does not require an adjustment in the computation. (8 marks)

(iv) The tax treatment of the proposed business of floriculture. (7 marks)

Professional marks will be awarded in question 1 for the appropriateness of the format and presentation of the report and the effectiveness with which the information is communicated. (4 marks)

(35 marks)

2 The tax manager of Tax Firm has received a call from Baba Charles (Baba), a Malaysian citizen, who is the managing director and 80% shareholder of Meja Manufacturing Sdn Bhd (MM). MM has a paid-up ordinary share capital of RM10 million.

MM manufactures office furniture and sells its products, under the brand name of 'Meja Bagus', through its wholly-owned marketing subsidiary, Trading Meja Sdn Bhd (TM). MM's main business premises is located in Selangor, Malaysia while TM's business is located in Johor, Malaysia. TM exports 80% of MM's products, mainly to Europe. TM also owns six residential apartments, from which it derives rental income.

MM and TM both make up accounts to 30 June annually.

Notes of the telephone conversation between the tax manager and Baba

- To achieve operational efficiency and simplify the corporate structure, Baba intends to consolidate the manufacturing and trading activities under MM from 1 April 2018. In this regard, TM will transfer the furniture trading business to MM. As a result, TM will become a property holding company deriving rental income from its residential apartments.
- Baba also believes that MM is paying too much goods and services tax (GST) and is considering ways to improve its GST position. In the past, on MM's anniversary, the company has given cash of RM1,000 to each of the directors and RM300 to each of the managers, as a gesture of appreciation. Baba is now considering buying hampers with the same cash value (GST inclusive) instead of making these gifts of money as, by doing so, MM will be eligible to claim the GST incurred on the purchase of the hampers. None of the company's employees are given any other free gifts by MM.

Baba has subsequently emailed the following financial information to Tax Firm:

Projected tax positions for the year of assessment 2019 (excluding rental income)

	NO CONSOLIDATION OF BUSINESS		CONSOLIDATION OF BUSINESS IN MM
	Meja Manufacturing Sdn Bhd (MM)	Trading Meja Sdn Bhd (TM)	Meja Manufacturing Sdn Bhd (MM)
	RM'000	RM'000	RM'000
Adjusted business income	10,000	60,000	70,000
Current year capital allowance	5,000	2,000	7,000
Unabsorbed capital allowance brought forward	50,000	Nil	50,000

Notes:

1. The above does not take into account any tax incentives which may be claimed.
2. On the basis that the consolidation of the business is completed on 1 April 2018, the analysis of the projected sales between export and local sales is as follows:

	Consolidation of business in MM RM'000
Projected sales for financial year ending:	
30 June 2018	
– Sales to overseas customers	90,000
– Sales to local customers	85,000
30 June 2019	
– Sales to overseas customers	210,000
– Sales to local customers	40,000

Financial information (continued)

3. TM's projected marketing expenses (with or without consolidation) are as follows:

	RM'000
Samples for overseas customers	1,000
Cost of maintaining a sales office in the UK	500
Billboard advertising in Malaysia	200
Billboard advertising in Europe	300
Trademark registration in Poland	60
Trademark renewal in Malaysia	40

Your tax manager has arranged a further meeting with Baba next week and in preparation for that meeting, your tax manager has requested you to carry out the following work:

(a) Proposed consolidation of businesses

Based on the marketing expenses and export profile of the businesses:

(i) Identify, explain and quantify the export incentives currently available to TM.

(ii) Identify, explain and quantify the additional incentive available to MM after the proposed consolidation takes place.

(iii) Identify and explain any other income tax and GST benefits of the proposed consolidation.

(b) Anti-avoidance considerations

Consider whether the proposed consolidation of the businesses could withstand a potential challenge from the Inland Revenue Board.

(c) Proposals to improve the GST position

Comment on the tax efficiency of the proposal to provide directors and managers with hampers in lieu of the gifts of money.

Required:

Carry out the work as instructed by your tax manager.

The following marks are available:

(a) Proposed consolidation of businesses:

(i) The incentives currently available to Trading Meja Sdn Bhd. (7 marks)

(ii) The additional export incentive available to Meja Manufacturing Sdn Bhd (MM) after consolidation. (6 marks)

(iii) The other income tax and goods and services tax (GST) benefits of consolidation (4 marks)

(b) Anti-avoidance considerations. (5 marks)

(c) The ability of the proposal to provide hampers in lieu of cash gifts to improve MM's GST position. (3 marks)

(25 marks)

Section B – TWO questions ONLY to be attempted

3 **(a)** Little Sdn Bhd (Little), a retail business with a paid-up ordinary share capital of RM1·8 million, is wholly-owned by Big Sdn Bhd (Big) which has a paid-up capital of RM20 million. Both companies close their accounts annually to 30 June.

Although profitable, Little has experienced cash flow problems. In July 2017, Big transferred cash of RM1 million to Little, specifically to help Little to settle trade debts and pay remuneration to its employees and so enable Little to continue to operate its retail business.

Big thinks that Little's cash flow position will not allow it to repay the RM1 million in the next five years, hence no interest has been charged nor terms of repayment set.

The board of directors of Big is now considering whether to categorise the RM1 million as a loan or as additional equity in Little. The following three alternative proposals have been suggested for the RM1 million:

(i) Categorise as additional ordinary share capital in Little.

(ii) Categorise as an interest-free loan to Little with no terms of repayment (i.e. as now).

(iii) Categorise as a loan to Little at the prevailing market interest rate effective from 1 July 2017, but with no interest due to be paid by Little until the financial year commencing 1 July 2020.

Required:

(i) Explain whether there will be any income tax impact on Little Sdn Bhd (Little) if the RM1 million is taken up as equity. (3 marks)

(ii) Explain the tax treatment from Little's perspective if the RM1 million is provided as an interest-free loan with no terms of repayment. (4 marks)

(iii) Explain the basis and timing of the following if the RM1 million is treated as a normal loan at a market interest rate:

- **the recognition of the interest income for Big Sdn Bhd, and**
- **the interest expense allowed to Little.**

In each case, state the relevant years of assessment. (7 marks)

(b) Medium Sdn Bhd (Medium) carries out mixed farming beside a river. As a result of poor maintenance by a factory situated upstream, excessive storm water flowed onto the farm land, and flooded it. This flooding caused extensive damage to the farm. In November 2017, Medium received RM600,000 in compensation as follows:

	RM
Loss of animal stock and crop	150,000
Degradation of farm land	280,000
Loss of trading profits	170,000

Required:

Explain the income tax treatment and real property gains tax treatment, if relevant, of each component item of the compensation received by Medium Sdn Bhd. (6 marks)

(20 marks)

4 **(a)** Ahmad is the sole proprietor of the English Proficiency Centre, which is based in Malacca. Ahmad conducts courses at the Centre and at the premises of his corporate clients in Malaysia and Singapore. He was in Singapore for 12 days in 2017 solely to conduct courses.

From his base in Malacca, Ahmad also reviews corporate communications such as brochures, press statements and reports for his clients in Malaysia and Singapore. His income for the year ended 31 December 2017 is analysed as follows:

		RM
Course fees:	courses conducted in Malaysia	56,000
	courses conducted in Singapore	9,000
Review fees:	Malaysian clients	27,000
	Singaporean clients	8,000
Total		100,000

Required:

(i) For each of the component items of Ahmad's income for the year of assessment 2017, explain whether it is derived from Malaysia and subject to tax in Malaysia. (10 marks)

(ii) State, giving reasons, whether Ahmad is likely to have a fixed base in Singapore for 2017. (2 marks)

(b) In 2015, Param gifted a rental property to Sathi, his 18-year-old granddaughter. The net rental income produced by this property in 2017 will amount to RM180,000.

Param died on 30 September 2017. His will stipulated that an annuity of RM48,000 should be paid to Sathi. On 30 December 2017, a pro-rated amount of RM12,000 will be paid to Sathi for the period October to December 2017. On 31 December 2017, Sathi intends to donate this entire sum of RM12,000 to an approved orphanage.

Sathi was awarded a scholarship worth RM80,000 to spend the year 2017 studying classical music in India. For this purpose, she left Malaysia for the first time on 1 January 2017 and will return to Malaysia on 31 December 2017. She has no plans to leave Malaysia again until 2019.

Required:

(i) State, giving reasons, why Sathi is a resident of Malaysia for the year of assessment (YA) 2017. (2 marks)

(ii) Compute Sathi's total income for YA 2017, giving brief explanations of the treatment of the rental income.

Note: Indicate with the word 'nil' any item of income which is not assessable. (6 marks)

(20 marks)

5 (a) In a proposed group reorganisation, Aay Sdn Bhd (Aay) plans to transfer its 300 acre oil palm plantation land (Parcel Z) to a fellow subsidiary, Bie Sdn Bhd (Bie), so that Aay may focus on the development and production of downstream palm oil products. Aay acquired Parcel Z in 2010 for RM1,680,000. The prevailing market value of Parcel Z is RM3 million. Both Aay and Bie are resident in Malaysia.

With this transfer, Bie's total oil palm land bank will increase to 800 acres and this will render its plantation operations more efficient.

If the property market is positive in seven years' time, Bie may reclassify Parcel Z as a current asset with a view to building residential and commercial properties on the land for sale to the public.

Required:

(i) Identify the real property gains tax (RPGT) relief which is available in respect of a transfer of chargeable assets within a group of companies, explain why the transfer of Parcel Z will potentially be eligible for this RPGT relief, and state the other requirements which must be satisfied in order to ensure eligibility and continued eligibility for the relief. (9 marks)

(ii) Explain the RPGT and income tax implications for Bie Sdn Bhd if, as proposed, it reclassifies Parcel Z as inventory for property development in seven years' time. (3 marks)

(b) Goode Sdn Bhd (Goode), which closes its accounts annually to 30 April, applied for a tax incentive in January 2017. Goode submitted its tax return for the year of assessment (YA) 2017 on 30 November 2017 and paid the self-assessed tax in full.

Yesterday, Goode received a letter dated 4 December 2017, which granted approval for the tax incentive it had applied for and of its claim for RM190,000 for YA 2017 and RM300,000 for YA 2019. As a result of this approval, Goode expects its tax payable for YA 2017 to be reduced.

Goode also estimates its tax liability for YA 2019 will only be RM10,000 compared to an estimated liability of RM100,000 for YA 2018.

Required:

(i) Explain the relief (other than for error and mistake) available to Goode Sdn Bhd (Goode) following approval of the tax incentive and the action which Goode must take in order to claim the tax incentive granted for the year of assessment (YA) 2017. (4 marks)

(ii) Explain the implications of the approval of the tax incentive for the tax estimate and tax instalments due by Goode for YA 2019 and the course of action available to Goode. (4 marks)

(20 marks)

End of Question Paper

1 Report to Highway Networks Group Berhad

From Tax Firm
To Board of directors, Highway Networks Group Berhad
Date 7 December 2017

This report outlines the key tax issues relating to the preparation of the tax computation of East Highway Sdn Bhd (EH) for the year of assessment (YA) 2017. In addition, the report will consider the tax implications arising from the proposed diversification of the group into the business of floriculture.

Tax issues relating to the preparation of EH's tax computation for YA 2017

(i) Tax treatment of other incomes and related expenses

Rental income received from retailers operating at rest areas
Along the highway, EH has rest areas whose retail outlets are let out to individual operators. EH actively manages and maintains the rest areas. On the basis that comprehensive and active maintenance services are provided to the individual operators by EH, the rental income should be treated as EH's business income [Public Ruling 1/2014].

In addition, the rest areas along the highway are provided for the convenience of the road users of the highway and, therefore, can be seen as incidental to the provision of the highway to these road users. Therefore, the rental income can be treated as an incidental business income to EH's toll income.

The related expenses incurred, i.e. the quit rent and assessment and the maintenance expenses, are tax deductible in arriving at EH's adjusted income.

Government grant
Income relating to a grant or subsidy given by the Federal Government or the State Government is specifically tax exempt [Income Tax (Exemption) (No. 22) Order 2006]. Further, where any expenditure incurred is reimbursed, in full or in part, by such exempt income, no deductions or allowances are to be made in relation to that expenditure.

The grant received during the financial year by EH of RM45 million is to partly cover the RM60 million cost of the construction of the additional lane. Thus the grant received is exempt from income tax. Correspondingly, the part of the construction cost of the additional lane being reimbursed by the grant is to be disregarded for tax purposes and, therefore, no industrial building allowance (IBA) can be claimed on that amount. As the total construction cost of the additional lane is RM60 million, EH will be able to claim IBA on the element of the construction cost not reimbursed of RM15 million (RM60 million – RM45 million).

The accounting treatment to amortise the grant received over the duration of the extended highway concession has no relevance to the tax treatment.

(ii) Tax treatment of the road development expenditure

Construction of an additional lane
Where, pursuant to an agreement with the government, a person incurs capital expenditure on the construction, reconstruction, extension or improvement of any public road and ancillary structures which expenditure is recoverable through toll collection, the road and ancillary structures expenditure is treated as an industrial building (IB) and the expenditure incurred thereon will qualify for IBA.

As the additional lane represents an improvement to the existing highway, such expenditure would constitute capital expenditure. As the lane has been completed and open for use, the capital expenditure has been incurred and the resultant asset put in use in the business, EH will be eligible to claim IBA of a 10% initial allowance and a 6% annual allowance. As stated above, as RM45 million of the construction cost of the new highway has been reimbursed by the government grant, the qualifying building expenditure on the road construction will be restricted to RM15 million.

Toll booths
EH will be eligible to claim IBA on the construction of the toll booths, being ancillary structures, when they are completed and put into use. In this regard, the construction cost of the new toll booths of RM5 million should qualify for IBA at the same rates as the road, i.e. 10% and 6%.

Resurfacing of existing roads
The resurfacing of roads is done to ensure that they are in good condition. Generally, repairs which do not materially add to the value nor appreciably prolong the life of an asset, but merely keep it in good and efficient operating condition, are revenue in nature and allowable as a tax deduction. Notwithstanding the fact that the resurfacing cost is capitalised, the resurfacing of roads is a periodic expenditure required to maintain them in good conditions. Thus the amount of RM18 million should be tax deductible.

(iii) EH's income tax computation for YA 2017

In order to illustrate the impact of the above treatments, we have prepared the income tax computation for YA 2017 (see the attached appendix). This shows that EH will have a chargeable income of RM20·8 million for YA 2017.

As the paid-up ordinary share capital of the company is only RM1 million and its related companies do not have a paid-up ordinary share capital of RM2·5 million, EH is eligible for the preferential tax rate for small and medium enterprise (SME). It should be noted that the redeemable preference share capital of RM100 million is not relevant in determining the share capital for SME tax rate purposes. Based on the SME tax rate, the tax payable by EH in YA2017 is RM4·962 million.

(iv) Tax treatment of the proposed business of floriculture

In order to increase its revenue, EH plans to diversify into the business of floriculture by planting orchids on land along the highway. The floriculture business would be managed by its existing workers. We understand that the orchid planting would also help to beautify the scenery along the highway.

The question is whether the income from the sale of the floriculture business should be regarded as a separate business source or incidental to the business of the highway concession. As the orchid planting is on land along the highway and will have the benefit of beautifying the highway, it can be argued that the income from the floriculture business should be treated as incidental income to the highway concession. In addition, the floriculture activities will be managed by the existing workers of EH. The fact that the orchids are mainly for export does not necessarily render the activity a separate business. Moreover, some of the orchids would be sold at the rest areas.

Irrespective of whether the floriculture income is treated as a separate or incidental business source for EH, the income will be subject to income tax as both businesses are profitable.

We have also considered whether the floriculture business should be carried out by GL instead of EH. As GL has a garden nursery business, it can be argued that the floriculture business is part of the same business as that of its existing nursery. In this respect, the income derived therefrom could be sheltered by the unabsorbed capital allowances and tax losses available in GL. Therefore, it may be beneficial for the floriculture business to be carried out by GL rather than EH, as this will maximise and speed up the utilisation of these unabsorbed tax balances in GL. Any surplus amount will be subject to tax at 18% rather than 24%.

------- End of report ---------

Appendix

East Highway Sdn Bhd (EH)
Income tax computation for the year of assessment (YA) 2017

	RM'000
Profit before taxation	40,000
Less:	
Rental from retailers operating at rest areas	Nil
Grant receivable	(3,000)
Interest income	(2,000)
Add:	
Quit rent and assessment for rest areas	Nil
Maintenance of rest areas	Nil
Finance cost – Term loan interest	Nil
Finance cost – Dividend on redeemable preference shares	5,000
Other tax deductible expenses	Nil
Resurfacing of road	(18,000)
Adjusted business income	22,000
Less: IBA (see working)	(3,200)
Statutory business income	18,800
Interest income	2,000
Aggregate income/total income/chargeable income	20,800
Tax payable	
First RM500,000 at 18%	90
Balance at 24%	4,872
	4,962

Working: IBA

	RM'000
Qualifying expenditure (completed additional lane to highway net of grant and toll booths)	
– Initial allowance [10% x (RM15m + RM5m)]	2,000
– Annual allowance [6% x (RM15m + RM5m)]	1,200
Resurfacing of existing roads	Nil
	3,200

2 Baba Charles

(a) Proposed consolidation of businesses

(i) Export incentives currently available

Based on the marketing expenses and export profile of the business, the following incentives are currently available to Trading Meja Sdn Bhd (TM):

Further deduction for promotion of exports
A resident company is eligible to claim a further deduction on qualifying expenses which are incurred primarily and principally for the purposes of seeking opportunities or in creating or increasing a demand for the export of goods manufactured in Malaysia. There is no requirement for the claimant to be the manufacturer of these goods.

Based on the marketing expenses incurred by TM, the following would be eligible for this further tax deduction:

	RM'000
Samples for overseas customers	1,000
Cost of maintaining a sales office in the UK	500
Trademark registration in Poland	60
	1,560

Further deduction for advertising expenditure on Malaysian brand name goods
A resident company which is at least 70% Malaysian owned and is either the registered proprietor of a Malaysian brand name or related to the registered proprietor is eligible to claim a further deduction for the qualifying advertising expenditure incurred on these Malaysian brand name goods. In order to qualify for this incentive, the goods must be of export quality, i.e. at least 20% of the total sales of the Malaysian brand name goods are exported.

TM should be eligible for the above further deduction and the billboard advertising expenses incurred in Malaysia of RM200,000 would be eligible for this incentive.

Tutorial note: *It should be noted that the trademark renewal in Malaysia is not eligible for any special or further deduction. The billboard advertising in Europe does not qualify because the IRB deems [in PR2013/1, paragraph 6.2.1] that advertising in 'media' does not include that on billboards and vehicles.*

(ii) Additional incentive available after the consolidation exercise

Tax exemption in relation to increased exports
Prior to the consolidation, TM is the exporter of the goods manufactured by Meja Manufacturing Sdn Bhd (MM). TM is not eligible for a tax exemption in respect of the export sales as this incentive is only given to a manufacturing company. A resident manufacturing company which is at least 60% Malaysian owned is eligible for the exemption of income for a significant increase in exports, penetration of new markets and export excellence award.

A significant increase in exports is defined as an increase in the value of the company's exports in the basis period for a year of assessment of at least 50%. MM will be eligible for this tax exemption because, based on its export profile for the year of assessment 2019, it is expected to achieve more than a 50% increase in export value as follows:

	RM'000
Export sales in the preceding year (A)	90,000
Export sales in the current year (B)	210,000
Increased exports for the year (C)	120,000
Percentage of increase (C/A x 100%)	133%

The amount of the tax exemption is equivalent to 30% of the value of the increased exports, i.e. in MM's case RM36 million (RM120 million x 30%). The amount exempted can be absorbed against up to 70% of the statutory income of the company and any amount unabsorbed may be carried forward to be set off in the subsequent years of assessment.

The amount exempted can be credited into an exempt income account whereby tax exempt dividends can be distributed.

(iii) Other tax benefits from consolidation

Income tax benefits
With the transfer of the trading furniture business from TM to MM, the trading business would be combined with that of the manufacturing business of MM. As the trading business relates to the sale of the manufactured goods and, therefore, can be treated as a single business source, MM can utilise the unabsorbed capital allowance brought forward against the combined profits of the consolidated business. This will accelerate the utilisation of the unabsorbed capital allowances and, therefore, reduce the overall tax exposure of the business. Also, as a consolidated business, it will not be subject to transfer pricing scrutiny.

Good and services tax (GST) benefits
From a GST perspective, without the consolidation, both MM and TM would be GST registrants and required to file GST returns separately. As TM has exempt supplies from the rental of residential properties, no group registration would have been allowed and MM would have needed to charge GST on the sale of the manufactured goods to TM. Whilst this GST could be claimed as an input tax credit in TM's GST return, as TM's supply is mainly in relation to the export of goods, a

zero rated supply, it is likely that TM would have been in a GST repayment position. This would have been inefficient in terms of the cash flow position of the group, as MM would have had to account for the output tax and TM would have needed to wait for the GST to be refunded.

With the transfer of the trading business into MM, TM will now only derive rental income which is an exempt supply. Therefore, TM will be able to deregister for GST and, moving forward, only MM will need to file GST returns. Further, as MM will be exporting the goods directly, it need only account for output tax on its standard rated sales of goods to the local market.

(b) Anti-avoidance considerations

The general anti-avoidance provision provides that where the Director General of Inland Revenue has reasons to believe that any transaction has the direct or indirect effect of altering the incidence of tax which is payable or which would otherwise have been payable by any person, he may disregard or vary the transaction and make such adjustments as he thinks fit for tax purposes with a view to counter-acting the whole or any part of any such direct or indirect effect of the transaction [under s.140 of the Income Tax Act, 1967].

Tutorial note: *The above is without prejudice to such validity as the transaction may have in any other respect or for any other purpose, apart from tax.*

However, based on established case law, if a transaction is capable of justification by reference to ordinary business dealings without necessarily being labelled as a means to avoid tax, then the arrangement should not be caught by the anti-avoidance provision. Therefore, it is of great importance that the taxpayer is able to demonstrate that any transaction entered into is driven by commercial expediency, and that any tax benefit derived is purely incidental, in order for it to counter a challenge of tax avoidance by the tax authorities.

In the present case, TM is the trading arm of MM whereby TM is responsible for the marketing and sale of the products manufactured by MM. Therefore, it is justifiable from a commercial perspective for the management to consolidate the operations under one company. Of course, in undertaking the consolidation exercise, Baba Charles could decide to consolidate the operations under TM instead of MM. However, it may make commercial sense to use MM as the surviving company as, generally, a manufacturing operation involves more assets and licences, hence, it is easier to transfer a trading operation as opposed to transferring a manufacturing operation. Therefore, consolidating the operations under MM may be argued to be not an arrangement to avoid tax. Also, the fact that the locations of the business premises of the two operations are different does not necessarily mean that these operations cannot be undertaken under the same company, particularly when both the manufacturing and trading activities form the same value chain of the manufacturing and distribution of office furniture.

Therefore, MM should be able to argue that the proposed consolidation exercise has commercial justification and it should reasonably be able to withstand an invocation of the anti-avoidance provisions.

(c) Proposal to provide hampers in lieu of gifts of money

The giving of cash to the directors and managers has no GST implications for MM.

Baba is right that if hampers are purchased and given to employees in recognition of their loyalty to the company, then the GST incurred on the purchase of such hampers should be allowed as an input tax credit as it will have been incurred in the furtherance of MM's business.

However, the question arises as to whether the giving of the hampers constitutes a supply for GST purposes and, therefore, requires output tax to be accounted for. Where goods forming part of the assets of a business are transferred or disposed of, whether or not for a consideration, the transfer or disposal is a supply of goods by that person, unless the gift of goods is made in the course or furtherance of the business and is made to the same person in the same year where the total cost to the donor is not more than RM500. In other words, a gift with a value of less than RM500 is not regarded as a supply subject to GST.

In the present case, the hampers given to the managers, with a cash value of RM300 each, would fall within the gift rule and there will not be any deemed supply. In this respect, MM would be eligible to claim the input tax on the purchase of the hampers with no requirement to account for output tax when the hampers are given out, resulting in a net GST claim to the company.

However, in relation to the gifts of hampers to the directors with a cash value of RM1,000, the provision of the hampers is deemed as a supply and MM is required to account for output tax on the deemed supply. The accounting of the output tax in this instance would negate the input tax credit available to MM on the purchase of the hampers. Therefore, the GST position of MM will not be improved. Moreover, the deemed output tax borne by the company would not be allowed as an income tax deduction.

3 (a) Big Sdn Bhd (Big) and Little Sdn Bhd (Little)

(i) RM1 million treated as equity

An increase of RM1 million in equity will mean higher single-tier dividend payout which is not deductible. Despite having a paid-up share capital of RM1·8 million, i.e. not exceeding the RM2·5 million, Little is nevertheless not a small and medium enterprise (SME) because Little is wholly-owned by Big, which has a paid-up share capital of RM20 million, i.e. more than the RM2·5 million SME threshold.

If Big takes up the RM1 million as additional ordinary share capital in Little, the paid-up share capital of Little will increase to RM2·8 million (RM1·8 million + RM1 million). However, as Little is already a non-SME and will remain one, there will be no impact as a consequence of exceeding the threshold in this way. Thus, Little will continue to be subject to tax at the standard rate of 24% and it will qualify for 100% write-off of small value assets of a value up to only RM13,000 for each year of assessment.

(ii) RM1 million as an interest-free loan with no terms of repayment

With no terms of repayment and no interest charge, the RM1 million is arguably not a loan: it is a grant. The grant will be a revenue grant as it is made specifically in order for Little to pay its trade debtors and employees, which are both revenue expenses. As the loan is from Big, a company, it is not a grant from the government, so it does not qualify for tax exemption. Therefore, the amount of RM1 million will represent a revenue grant duly subject to tax as business income in the hands of Little.

Tutorial note: *An additional or alternative argument would be that the amount of RM 1 million is effectively an amount received by way of recoupment, recovery or reimbursement of sums in respect of outgoings and expenses deductible in ascertaining the adjusted income from Little's retail business. Pursuant to the law [s.22(2)(a)], this amount is deemed to constitute gross income from that retail business.*

(iii) RM1 million as a market-rate loan

Interest is taxable when it is received. However, when received, it is related back to the period for which it is receivable. Where the loan is between related parties, the lender is deemed to be able to obtain such interest on demand when it is 'due to be paid' [s.29(3)].

As a market-rate loan, interest is due to be paid from July 2020, therefore, the interest first becomes 'due to be paid' to Big only in the year of assessment (YA) 2021 (1 July 2020 to 30 June 2021).

As Big has control of Little by virtue of its 100% shareholding, it is deemed to be able to obtain the interest on demand when the interest is due to be paid, i.e. in the year ending 30 June 2021. The interest, thus deemed obtainable on demand, will be taxed on Big for the period for which it is receivable, i.e. YA 2018 to YA 2021.

The interest expense on the loan is tax deductible in Little only when the interest is due to be paid, i.e. in YA 2021, but related to the period for which the interest is payable [s.33(4)], i.e. YA 2018 to YA 2021. This would require Little to notify the Director General of Inland Revenue (DGIR) within 12 months from the end of the basis period for the YA in which the interest is due to be paid, that is by 30 June 2022. The assessments for YAs 2018 to YA 2020 may then be reduced accordingly by the DGIR [s.33(5)].

(b) Medium Sdn Bhd compensation received

Loss of animal stock and crop RM150,000
Animal stock and crop constitute inventory to the mixed farm business. Therefore, this is a revenue loss. The compensation for a revenue loss constitutes gross income subject to tax.

Degradation of farmland RM280,000
The farmland represents a non-current asset to the farm business. This is a capital loss. The compensation for a capital loss being capital in nature is not subject to income tax.

From the perspective of real property gains tax (RPGT), the amount received will be deducted in arriving at the acquisition price of the farm land as this represents compensation for any kind of damage to the asset [Paragraph 4(1)(a), Schedule 2, RPGT Act].

Loss of profits RM170,000
Compensation for a loss of trading profits is revenue in nature and subject to tax by virtue of the law [s.22(2)(b)] which states that compensation for a loss of income constitutes gross income from that source.

4 (a) English Proficiency Centre (EPC)

(i) Derivation and taxability of income

Course fees: conducted in Malaysia	The activity is carried out in Malaysia in the furtherance of EPC's business. Therefore, the income is derived from Malaysia and duly subject to tax in Malaysia.
Course fees: conducted in Singapore	The activity of delivering courses in Singapore is a parallel activity executed outside Malaysia, and is not incidental to the carrying out of courses in Malaysia. Therefore, this income is not derived in Malaysia, it is foreign-sourced income and when remitted to Malaysia, is specifically exempt from income tax [paragraph 28, Schedule 6].

Tutorial note: *An alternative answer would be that, although the delivery of the courses occurs in Singapore, the preparation and arrangements are likely to have been made in Malaysia. Therefore, it may be argued that the delivery of the courses in Singapore is incidental to the business carried out in Malaysia, in which case, the income from the courses conducted in Singapore will be considered as derived from Malaysia and duly subject to tax in Malaysia.*

Review fees for Malaysian clients	This is a component activity of EPC and is carried out in Malaysia. The income is derived from Malaysia and duly subject to tax in Malaysia.
Review fees for Singapore clients	Similarly, this activity is carried out in Malaysia. The fact that the clients are from Singapore does not change the fact that the activity is carried out in Malaysia. The income is derived from Malaysia and subject to tax in Malaysia regardless of whether the amount is remitted to Malaysia.

(ii) Fixed base in Singapore

Ahmad was in Singapore for 12 days in 2017 solely to conduct courses. Although the activity of conducting courses is an integral activity of his business, the short duration and the fact that he does not carry out any other business activity in Singapore would suggest that he has no fixed base in Singapore.

(b) Sathi

(i) Residence

Sathi has never left Malaysia until 1 January 2017 when she travelled to India. She will return to Malaysia on 31 December 2017.

In 2017, Sathi will have been in Malaysia for the previous 20 years, thereby fulfilling the rule [under s.7(1)(d)] that she was a resident of Malaysia for the three immediately preceding years of assessment (YA), i.e. YAs 2014, 2015 and 2016; she also plans to be resident for the YA immediately following 2017, i.e. YA 2018. Therefore, despite being in Malaysia for only two days in 2017, Sathi is a resident of Malaysia for YA 2017. Alternatively, she also qualifies for residence in YA 2017 by virtue of the fact that she was in Malaysia on 1 January 2017 which is connected to a period of 365 days in 2016, or on 31 December 2017 which is connected to a period of 365 days of 2018.

(ii) Total income for YA 2017

	RM
Rental income	
1 January 2017 to 30 September 2017	
Rental income of RM135,000 (180,000/12 x 9) is taxable in the hands of Param, as the rental property transferred to Sathi by her grandfather falls to be treated as a settlement [under s.65]	Nil
1 October 2017 to 31 December 2017	
Following the demise of her grandfather, the settlor, the rental income becomes taxable in the hands of Sathi (180,000/12 x 3)	45,000
Annuity (specifically taxable [s.64(3)(b) and (c)])	12,000
Scholarship (exempt [Paragraph 24, Schedule 6])	Nil
Aggregate income	57,000
Less: Approved donation RM12,000 (restricted to 7% of RM57,000)	(3,990)
Total income	53,010

5 (a) Aay Sdn Bhd and Bie Sdn Bhd

(i) Real property gains tax (RPGT) relief

Pursuant to the law [paragraph 17(1)(a), Schedule 2, Real Property Gains Tax Act], where an asset is transferred between companies in the same group, the transfer may be deemed to take place at no gain/no loss, provided certain conditions are met.

There is a three-year moratorium during which period the transferee company must maintain/retain its residence status in Malaysia and both transferor and transferee companies must remain in the same group.

The proposed transfer of Parcel Z is potentially eligible for this RPGT relief because:

– the transfer is between Aay Sdn Bhd (Aay) and Bie Sdn Bhd (Bie), two subsidiaries in the same group;

– Bie, the transferee company, is resident in Malaysia; and

– the transfer of Parcel Z will achieve greater efficiency in the group operations, as Aay will focus on development and production of downstream palm oil products, while Bie will achieve higher efficiency in plantation operations with a higher acreage.

To ensure the transfer of Parcel Z is eligible for the relief:

– the group must apply for and obtain approval from the Director General of Inland Revenue (DGIR) **before** the transfer is effected; and

– the consideration for the transfer must be in shares or substantially in shares, i.e. to the extent of at least 75%, with the balance, if any, as a money payment.

To ensure its continued eligibility for the relief, the group must ensure that for the three years after the date of the DGIR's approval:

- Bie, the transferee company, does not cease to be resident in Malaysia; and
- both Aay and Bie continue to be companies in the same group.

(ii) Subsequent reclassification of Parcel Z as inventory

Pursuant to the law [paragraph 17A Schedule 2 of RPGT Act], if Bie reclassifies Parcel Z as inventory, it will mean taking it into trading stock. This taking into inventory and conversion into a current asset will be deemed to be a disposal of a chargeable asset by Bie and Bie will be liable to RPGT on this deemed disposal. The disposal price of the chargeable asset is deemed to be its prevailing market price. The acquisition price for Bie is the original acquisition price of RM1,680,000.

From an income tax perspective, the cost of Parcel Z as inventory in the property development business will be the prevailing market value (price) at the time of its reclassification.

(b) Goode Sdn Bhd

(i) Relief available (other than for error and mistake)

Under the Act [s.131A], if any person who has paid tax for any year of assessment (YA) under self -assessment [s.77A(1)], alleges that the tax is excessive because the approval for a tax deduction is granted after the YA in which the return is furnished, they may apply to the Director General of Inland Revenue (DGIR) for relief.

The application must be made in writing within five years after the end of the year in which the deduction (incentive) was granted.

The deadline for Goode Sdn Bhd (Goode) to apply to the DGIR for relief [under s.131A] in the form of a reduced assessment will therefore be 31 December 2022, i.e. within five years from 31 December 2017.

(ii) Estimate of tax for YA 2019

Goode has to furnish an estimate of tax payable (ETP) for YA 2019 by 1 April 2018. The ETP must be for at least 85% of the ETP of the preceding YA 2018, i.e. for RM85,000 (RM100,000 x 85%).

Following the approval of the tax incentive of RM300,000 for YA 2019, Goode now expects its tax liability for YA 2019 to be only RM10,000. Nevertheless, Goode is obliged to estimate its tax payable for YA 2019 at RM85,000 by 1 April 2018 and proceed to pay the four monthly instalments for June 2018 to September 2018.

In the sixth month of the basis period for YA 2019, i.e. October 2018, Goode is able to submit a revised ETP from RM85,000 to RM10,000. With the revised ETP, Goode will no longer need to pay any tax instalments from October 2018 onwards as the amount already paid of RM28,332 (RM7,083 (RM85,000/12) x 4) exceeds the amount of the revised estimate of RM10,000.

Tutorial note: *An alternative answer would be that, in practice, with the DGIR's approval, an ETP lower than the preceding year's ETP/revised ETP may be allowed . In this case since Goode has a valid reason for a much lower ETP, it can reasonably expect the DGIR's approval. If this is the case, then the instalment payments for the 12 months commencing June 2018 will be based on the lower ETP of RM10,000, which will result in an improvement in Goode's cash flow.*

			Marks
1	**(i)**	**Tax treatment of other income and related expenses**	
		Rental income	
		Active comprehensive services	1
		For the benefit of the road users, incidental	1
		Deductibility of expenses	1
		Government grant	
		Exemption	1
		Expenses/QE disregarded	1
		Eligible QE for IBA	1
		Amortisation/accounting treatment not relevant	1
		Available	7
		Maximum	6
	(ii)	**Tax treatment of road development expenditure**	
		Construction of additional lane	
		Improvement – capital	1
		Lane completed – incurred and in use	1 + 1
		Eligible QE, restricted by grant	1 + 0·5
		Toll booths	
		Ancillary structures	1
		Eligible for IBA, completed and put into use, rates as for road	1 + 0·5 + 0·5
		Resurfacing of road	
		No element of improvement	1
		Revenue in nature, hence deductible	1 + 0·5
		Capitalisation for accounting purposes notwithstanding	1
		Available	11
		Maximum	10
	(iii)	**Income tax computation**	
		Tax adjustment	
		Rental	0·5
		Grant receivable	0·5
		Interest income	1
		Quit rent	0·5
		Maintenance	0·5
		Finance cost – term loan interest	0·5
		Finance cost – redeemable preference share dividend	1
		Resurfacing of roads	0·5
		IBA calculation: QE, IA, AA	0·5 + 0·5 + 0·5
		Interest income	0·5
		Tax payable calculation	0·5
		Basis of tax rate explanation	1·5
		Available	9
		Maximum	8

		Marks
(iv) Tax treatment of the proposed business of floriculture		
Business income, separate v incidental		1
Basis to support incidental income		2
Fact mainly for export not critical		1
No tax impact whether separate or incidental		1
Tax impact if carried out by GL		2
Conclude GL more efficient vehicle		1
	Available	8
	Maximum	7
Professional marks		
Format and presentation of the report		1
Clarity and effectiveness of communication including logical flow		2
Appropriate use of appendix		1
		4
		35

			Marks
2 (a) (i)	**Export incentives available**		
	Further deduction on export of goods, basis of eligibility		1 + 2
	Eligible amount (3 x 0·5)		1·5
	Further deduction on advertising expenses, basis of eligibility		1 + 2
	Eligible amount		0·5
		Available	8
		Maximum	7
(ii)	**Additional incentive after consolidation**		
	Tax exemption for increased exports, basis of eligibility		1 + 1
	Significant increase in exports: definition, calculation		1 + 1
	Tax exemption: definition, value		0·5 + 0·5
	70% restriction		1
	Payment of exempt dividends		0·5
		Available	6·5
		Maximum	6
(iii)	**Other taxes benefits of consolidation**		
	Income tax		
	Single business		1
	Utilisation of unabsorbed CA		1
	No TP scrutiny		1
	GST		
	Tax returns		1
	Cash flow		1·5
		Available	5·5
		Maximum	4
(b)	**Anti-avoidance considerations**		
	Anti-avoidance rule		2
	Commercial basis		1
	Analysis		3
		Available	6
		Maximum	5
(c)	**Proposal for hampers v cash gifts**		
	Cash gifts – no GST		0·5
	Baba correct re input credit on purchase of hampers		0·5
	Application of gift rule		1
	Treatment of RM300 hamper		0·5 + 0·5
	Treatment of RM1,000 hamper		0·5 + 0·5
		Available	4
		Maximum	3
			25

					Marks
3	(a)	(i)	**RM1 million as equity**		
			Higher equity, higher dividend, not deductible		1
			Already not an SME, reason		0·5 + 1
			Increased share capital will not result in any change to non-SME status		1
			Continued tax treatment		0·5 + 0·5
				Available	4·5
				Maximum	3
		(ii)	**RM1 million as an interest-free loan with no terms of repayment**		
			No interest-rate, no terms of repayment, not a loan, no interest deduction		0·5 + 0·5 + 0·5
			Conclusion: it is a grant/subsidy		0·5
			Revenue grant, reason		0·5 + 0·5
			Not a grant from the government, not eligible for exemption		0·5
			Conclusion: grant subject to tax		0·5
					4
		(iii)	**RM1 million as a normal market-rate loan**		
			Interest income for Big		
			Principles: when received, but then related to when receivable		0·5 + 1
			Obtainable on demand, with reason		1
			Application: receivable year ended 30 June 2021, taxed in YAs 2018 to 2021		0·5 + 0·5
			Interest expense for Little		
			When due to be paid/YA 2021		1
			Related back to period for which payable, YAs 2018 to 2020		1 + 1
			Notification to DG to revise, within 12 months		1 + 0·5
				Available	8
				Maximum	7
	(b)	**Compensation**			
		Loss of animal stock and crop			2
		Degradation of farmland			
			Income tax		2
			RPGT		1
		Loss of profits			2
				Available	7
				Maximum	6
					20

					Marks
4	**(a)**	**(i)**	**Derivation and taxability**		
			Fees: courses in Malaysia		1 + 1
			Fees: courses in Singapore		2 + 2
			Review fees: Malaysian clients		1 + 1
			Review fees: Singapore clients		1 + 2
				Available	11
				Maximum	10
		(ii)	**Fixed base in Singapore**		
			Short duration		0·5
			No other business activities		0·5
			Conclusion – no fixed base		1
					2
	(b)	**(i)**	**Residence status**		
			Resident for three out of four immediately preceding years		1
			Resident in year immediately following		1
			Additional reasons (either)		0·5
			Conclusion: resident		0·5
				Available	3
				Maximum	2
		(ii)	**Total income**		
			Rental income		2 + 1·5
			Annuity		1
			Scholarship		1
			Approved donation		1
				Available	6·5
				Maximum	6
					20

					Marks
5	**(a)**	**(i)**	**RPGT relief**		
			Intra-group transfer, deemed at no gain/no loss		1 + 1
			Eligibility		
			Aay and Bie in the same group		1
			Bie is resident		1
			Transfer for greater efficiency of operation, how		1 + 0·5
			Prior approval of DGIR		1
			Form of consideration		1
			Continued eligibility		
			Three-year moratorium		1
			Residence of Bie, both group companies		0·5 + 0·5
				Available	9·5
				Maximum	9
		(ii)	**Subsequent reclassification as inventory**		
			RPGT:		
			Deemed disposal, RPGT payable by Bie		1 + 0·5
			Disposal price at market value		0·5
			Acquisition price at original price		0·5
			Income tax:		
			Cost as inventory deemed market value		1
				Available	3·5
				Maximum	3
	(b)	**(i)**	**Relief available**		
			Conditions: paid tax, self-assessment, excessive tax		0·5 + 0·5 + 0·5
			Reason delayed approval of tax deduction/incentive		1
			Apply to DGIR		1
			Within five years, deadline		1 + 0·5
				Available	5
				Maximum	4
		(ii)	**Estimate of tax for YA 2019**		
			Compulsory 85%, deadline		1 + 0·5
			Four instalments, starting June 2018		0·5 + 0·5
			Can revise in sixth month, October		1 + 0·5
			No further instalments, with reason		0·5 + 0·5
				Available	5
				Maximum	4
					20

Examiner's report

P6 (MYS) Advanced taxation

December 2017

General Comments

The examination consisted of two sections. Section A contained two compulsory questions, question 1 for 35 marks and question 2 for 25 marks. Section B comprised three further questions of 20 marks each, from which the candidates were required to answer two questions.

The vast majority of candidates attempted all four questions required, and there was little evidence of time pressure. Where questions were left unanswered by candidates, this appeared to be due to a lack of knowledge or poor exam technique, as opposed to time pressure.

Candidates are urged to read the requirements carefully, as further explained in the specific comments below.

Specific Comments

Question One

This 35 mark question was based on a company with a tolled highway concession, and its fellow subsidiary engaged in a garden nursery business.

Part (i) for 6 marks tested the tax treatment of rental income from operating the rest areas along the highway and a government grant received to partially defray capital expenditure. This was satisfactorily responded to. Many candidates cogently reasoned why the rental income constituted a business source and further whether it was a separate business source or part and parcel of the highway toll business.

Part (ii) for 10 marks tested the concept of capital expenditure on new assets versus revenue expenditure on maintenance of an existing asset. It also brought out the point of divergence between the tax treatment and the accounting treatment. This was generally well answered.

Part (iii) offered 8 marks for a tax computation. The requirement specified that candidates should assume that the rental income was part of the highway toll business. Some candidates neglected this assumption and went on to compute their answer based on rental income as a separate business source.

Part (iv) required tax planning by applying basic principles of the set off of capital allowances and losses in a single source and in separate sources. This was generally well done.

Question Two

This 25 mark question covered the topics of export incentives to a trading and/or manufacturing company, consolidation of two businesses under one company and the impact on income and Goods and Services Tax (GST), anti-avoidance provisions, and the GST impact on gifts to employees.

Many candidates discussed at length incentives such as pioneer status, investment tax allowance and reinvestment allowance, while others were not clear on what export incentives were available to a trading company and to a manufacturing company.

When considering the impact of the consolidation on GST, many candidates talked about a group registration when the trading business had been taken over by the manufacturing company.

The defence against a potential invocation of anti-avoidance provisions on the consolidation exercise was poorly argued out.

Question Three
This 20 mark question was comprised of two parts. Part (a) for 14 marks, tested candidates on the relative tax impact of a parent company giving a sum of money to a poor-performing subsidiary in the form of additional equity, interest-free loan and interest-bearing loan at market rate, and the treatment of interest expense and interest income. All three sub-parts were not well answered.

Part (b) for 6 marks, related to compensation received for the loss of inventory, degradation to a fixed asset, and for the loss of profits. This was well answered by most candidates who attempted Q3.

Question Four
Part (a) of this 20 mark question, for 12 marks, tested the derivation of service income in various situations, while part (b), for 8 marks, tested residence of an individual, income of a minor in a settlement and inheritance and the concept of "fixed base" for an individual.

This question was very well done, demonstrating that candidates had the ability to apply the source rules to specific situations.

Question Five
This 20 mark question tested the real property gains tax (RPGT) relief available on an intra-company transfer of chargeable assets and two aspects of tax administration.

Part (a) worth 12 marks, and relating to RPGT was not as well responded to as was expected. Careful reading of the requirements was important here. Candidates were required to first identify the relief, then explain why the transaction potentially qualified for the relief, and thirdly state what was needed to continue being eligible. Many candidates regurgitated what they know about the relief rather than providing a specific answer as required.

Part (b) worth 8 marks, tested the relief available to a taxpayer to have a tax assessment reduced because of a late approval of an incentive applied for, and the impact this has on the tax estimate in a coming year. This part was poorly attempted.

Professional Level – Options Module

Advanced Taxation (Malaysia)

March/June 2018 – Sample Questions

P6 MYS ACCA

Time allowed: 3 hours 15 minutes

This question paper is divided into two sections:

Section A – BOTH questions are compulsory and MUST be attempted

Section B – TWO questions ONLY to be attempted

Tax rates and allowances are on pages 2–4

Do NOT open this question paper until instructed by the supervisor.

This question paper must not be removed from the examination hall.

Paper P6 (MYS)

Think Ahead ACCA

The Association of Chartered Certified Accountants

SUPPLEMENTARY INSTRUCTIONS

1. You should assume that the tax rates and allowances shown below will continue to apply for the foreseeable future.
2. Calculations and workings should be made to the nearest RM.
3. All apportionments should be made to the nearest whole month.
4. All workings should be shown.

TAX RATES AND ALLOWANCES

The following tax rates, allowances and values are to be used in answering the questions.

Income tax rates

Resident individual

Chargeable income			Rate	Cumulative tax
	RM	RM	%	RM
First	5,000	(0 – 5,000)	0	0
Next	15,000	(5,001 – 20,000)	1	150
Next	15,000	(20,001 – 35,000)	5	900
Next	15,000	(35,001 – 50,000)	10	2,400
Next	20,000	(50,001 – 70,000)	16	5,600
Next	30,000	(70,001 – 100,000)	21	11,900
Next	150,000	(100,001 – 250,000)	24	47,900
Next	150,000	(250,001 – 400,000)	24·5	84,650
Next	200,000	(400,001 – 600,000)	25	134,650
Next	400,000	(600,001 – 1,000,000)	26	238,650
Exceeding	1,000,000		28	

Resident company

Paid up ordinary share capital	First RM500,000	Excess over RM500,000
RM2,500,000 or less	18%	24%
More than RM2,500,000	24%	24%

Non-residents

Company	24%
Individual	28%

Labuan entity – income from a Labuan trading activity

All chargeable profits	3%

Trust body – resident or non-resident

All chargeable income	24%

Personal deductions

		RM
Self		9,000
Disabled self, additional		6,000
Medical expenses expended on parents	(maximum)	5,000
Medical expenses expended on self, spouse or child with serious disease, including up to RM500 for medical examination	(maximum)	6,000
Parental care	(each)	1,500
Basic supporting equipment for disabled self, spouse, child or parent	(maximum)	6,000
Study course fees for skills or qualifications	(maximum)	7,000
Lifestyle allowance	(maximum)	2,500
Spouse relief		4,000
Disabled spouse, additional		3,500
Child – basic rate	(each)	2,000
Child – higher rate	(each)	8,000
Disabled child	(each)	6,000
Disabled child, additional	(each)	8,000
Childcare (below six years old)	(each)	1,000
Breastfeeding equipment	(maximum)	1,000
Life insurance premiums and contributions to approved funds	(maximum)	6,000
Private retirement scheme contributions, deferred annuity premiums	(maximum)	3,000
Medical and/or education insurance premiums for self, spouse or child	(maximum)	3,000
Deposit for a child into the National Education Savings Scheme	(maximum)	6,000
Contribution to Social Security Organisation (SOCSO)	(maximum)	250

Rebates

Chargeable income not exceeding RM35,000	**RM**
Individual – basic rate	400
Individual entitled to a deduction in respect of a spouse or a former wife	800

Capital allowances

	Initial allowance (IA) Rate %	**Annual allowance (AA) Rate %**
Industrial buildings	10	3
Plant and machinery – general	20	14
Motor vehicles and heavy machinery	20	20
Office equipment, furniture and fittings	20	10
Agriculture allowance		
Buildings for the welfare of or as living accommodation for farm employees	Nil	20
Other buildings used in the business	Nil	10
All other qualifying agricultural expenditure	Nil	50

Real property gains tax (RPGT)

	Companies	Individuals – non-citizens and non-permanent residents	All others
	Rate %	Rate %	Rate %
Category of disposal			
Disposal within three years after the date of acquisition	30	30	30
Disposal in the fourth year after the date of acquisition	20	30	20
Disposal in the fifth year after the date of acquisition	15	30	15
Disposal in the sixth year after the date of acquisition or thereafter	5	5	0

Goods and services tax (GST)

Standard rate	6%

Stamp duty

Rates of duty under the First Schedule

Conveyance, assignment, transfer or absolute bill of sale

	Rate %
Sale of property	
For every RM100 or fractional part thereof:	
On the first RM100,000	1
On the next RM400,000	2
On the excess over RM500,000	3
Sale of company shares	
On every RM1,000 or fractional part thereof	0·3

Section A – BOTH questions are compulsory and MUST be attempted

1 You are a tax associate of Tax Firm. On 5 December 2017, you and your tax director met with Taufik Murad, the chief financial controller of Aggresif Berhad (AB), a company listed in the Bursa Malaysia.

AB was initially involved in investment holding, share dealing and furniture manufacturing. In the past five years, AB has expanded aggressively by investing in various subsidiary companies involved in healthcare, information technology (IT) and green technology. All of the group companies make up their accounts to 31 May annually.

Below are the notes taken from this client meeting.

Notes of meeting with AB

– The board of directors of AB met recently and decided to rationalise its diversified businesses so that the group will only focus on healthcare and related businesses. The non-core businesses will, over time, all be divested. For the financial year ended 31 May 2018, the following transactions were undertaken:

– **Divestment of shareholding in Hijau Technologi Sdn Bhd (HTSB)**

HTSB is involved in the business of providing energy efficiency consultancy services to building owners. AB acquired a 70% shareholding in HTSB on 15 July 2016 for RM1·5 million to penetrate into the green technology sector. The acquisition was financed through a bank overdraft. As AB had no experience in green technology, it retained the entire HTSB management team to run the business and nominated a non-executive director for HTSB's board of directors to oversee its interest in HTSB.

In March 2018, a Singapore investor approached AB with a good offer for all of AB's shares in HTSB. AB accepted this offer and sold its entire shareholding in HTSB on 10 April 2018 for RM8 million.

– **Cessation of the furniture manufacturing business**

AB agreed with a competitor manufacturer, Good Furniture Sdn Bhd (GF), to take over AB's factory land and building together with its permanently-affixed machinery. In order to assist GF with the financing of this acquisition, the assets were sold to an unrelated listed company, LC Bhd (LC), from which GF will lease the assets for its sole use. The sale to LC was completed on 2 May 2018 for RM20 million, following which AB ceased its furniture manufacturing business.

On 10 May 2018, AB signed a conditional agreement for the disposal of the balance of the furniture manufacturing business assets, comprising moveable plant and machinery and customer database to another unrelated company, Happy Woods Sdn Bhd (HW). The sale of these assets is expected to be completed in November 2018. As at the end of AB's financial year ended 31 May 2018, these assets have been reclassified from property, plant and equipment to 'assets held for sale'.

– Details of the assets of the furniture manufacturing business are as follows:

	Date of acquisition	Acquisition cost RM'000	Sale consideration RM'000
Assets sold to LC			
Land	14 August 2011	9,000	10,000
Factory building (put into use)	23 December 2012	5,000	6,000
Permanently-affixed machinery	14 January 2014	8,000	4,000
Assets to be sold to HW			
Moveable plant and machinery	30 March 2014	6,500	5,000
Customer database	Not applicable	Nil	2,000

Notes of meeting with AB (continued)

– AB provided details of its statement of profit or loss for the year ended 31 May 2018 as follows:

	RM'000	RM'000
Furniture sales		50,000
Cost of sales		(45,000)
Gross profit		5,000
Other income		
– Dividend income		6,000
– Gain from the disposal of shares in HTSB		6,500
– Gain from the sale of manufacturing assets to LC		4,000
		21,500
Less: Expenditure		
Loss from the trading of portfolio shares	200	
Staff redundancy costs due to the cessation of business	1,500	
Commission for sale of shareholding in HTSB	800	
Other expenses (see note)	8,500	(11,000)
Profit before depreciation and taxation		10,500

Note: Included in 'Other expenses' are administrative expenses of RM500,000 incurred after 2 May 2018.

– As a result of the sales made to the Singapore investor and LC, AB has excess cash. Pending the identification of new business opportunities, the company is considering the following short-term investments:
  - Bonds issued by the Government;
  - Short-term loans to Ace Sdn Bhd (Ace), a Malaysian company, and Best Pte Ltd (Best), a Singapore company, at the prevailing interest rate of 6%. Ace will utilise the loan to acquire a rental property in Penang, while Best will utilise the loan as working capital financing for its trading business in Singapore.

Your tax director has sent you an email requesting you to prepare a report for the board of directors of AB, which addresses the following:

(i) The tax treatment of the gain from the sale of the HTSB shares. You should present arguments for and against the taxability of this gain, and Tax Firm's view on the appropriate tax treatment.

(ii) The income tax treatment of the sale of the furniture manufacturing business assets:
- factory land and building together with the permanently-affixed machinery;
- moveable plant and machinery; and
- customer database.

(iii) The real property gains tax (RPGT) treatment of the sale of the factory land and building, together with the permanently-affixed machinery. In particular, whether the sales consideration relating to the affixed machinery should be subject to RPGT, the basis on which the disposal price and the acquisition price will be determined and the treatment of any resulting chargeable gain/allowable loss.

(iv) An income tax computation for AB for the year of assessment 2018, including detailed calculations of any capital allowances/balancing adjustments. For this purpose, you should assume that the gains from the disposal of the HTSB shares will be subject to income tax.

(v) Whether the return generated from each of the short-term investments being considered by AB will be treated as derived from Malaysia and subject to tax in Malaysia.

Required:

Draft the report to Aggresif Berhad as instructed by your tax director.

The following marks are available:

(i) The taxability of the gain on the sale of the shares in Hijau Teknologi Sdn Bhd. (6 marks)

(ii) The tax treatment (in narrative form) of the sale of the furniture manufacturing assets.

Note: Calculations are NOT required at this stage. (8 marks)

(iii) The real property gains tax (RPGT) treatment of the sale of the factory land and building, together with the permanently-affixed machinery. (4 marks)

(iv) The tax payable by Aggresif Berhad for the year of assessment 2018.

Note: You should start your tax computation with the net profit figure and indicate with the word 'nil' any item which does not require adjustment. (9 marks)

(v) The tax treatment of the three short-term investments. (4 marks)

Professional marks will be awarded in question 1 for the appropriateness of the format and presentation of the report and the effectiveness with which the information is communicated. (4 marks)

(35 marks)

2 The tax director of Tax Firm has received an email from Reynold Lee, the finance director of Star Manufacturing Sdn Bhd (Star), requesting an urgent meeting to discuss a number of tax issues facing the company.

Star is owned by a group of Malaysian individuals, and has a paid-up ordinary share capital of RM5 million. Star has been manufacturing surgical gloves since its incorporation in 2007 and makes up its accounts to 31 December annually.

Excerpts from the email from Reynold Lee

Investment proposal

I will be presenting a proposal at the next meeting of the board of directors for approval to embark on an investment to construct an additional factory to manufacture a new product, medical gowns.

If approved, the construction of the factory will begin in July 2018 and will be ready to commence production in June 2019. The Malaysian Investment Development Authority (MIDA) has confirmed to Star that the manufacture of medical gowns is a promoted product under the normal category and eligible for the investment tax allowance (ITA) incentive.

If the ITA is granted, the medical gowns must be treated as a separate source from the surgical gloves. Otherwise, the two products could be considered as a single business source.

Star has been granted the ITA for the manufacture of surgical gloves in the past and has been claiming the reinvestment allowance (RA) incentive since the year of assessment (YA) 2014. I understand that both the ITA and RA are calculated based on 60% of the qualifying expenditure. Since the ITA and RA are mutually exclusive, should Star just continue claiming the RA incentive?

To facilitate your evaluation, I set out below the key financials of the proposed investment:

	Financial year to 31 December			
	2018	2019	2020	2021
	RM'000	RM'000	RM'000	RM'000
Medical gowns				
Investment amount				
– Factory (Note 1)	4,000	1,000		
– Plant and machinery (Note 2)		6,000		2,000
Statutory income		500	3,000	3,000
Surgical gloves				
Investment amount				
– Plant and machinery (Note 3)			3,500	
Statutory income		4,000	6,000	6,000

Notes:

1. 20% of the factory will be used for the storage of raw materials.
2. The amount incurred for the financial year 2021 represents the replacement of worn out machinery.
3. The investment in the financial year 2020 relates to the automation of the manufacturing process.

Tax audits

Last week, Star received notification from the Inland Revenue Board (IRB) of a tax audit. The IRB has recently concluded a tax investigation of Star, commenced earlier in the year, as a result of which the IRB issued a composite assessment for YAs 2011 to 2013. The IRB has now given Star notification of the commencement of a tax audit for YAs 2013 to 2015 inclusive. Can the IRB still carry out these proposed tax audits?

Excerpts from the email from Reynold Lee (continued)

Last week, Star was visited by the Royal Malaysian Customs Department (RMCD) for the purposes of a goods and services tax (GST) audit. During the RMCD visit, the officers scrutinised our input tax claims for the taxable periods in the year 2017. They discovered the following items where Star may have over-claimed input tax:

	RM
Purchase of a passenger car for use by the managing director	12,000
Purchase of raw materials for surgical gloves, issued in the name of a shareholder	20,000
Purchase of hampers as free gifts to customers where no deemed output tax was accounted for	5,000

Can you review the above and comment on whether the RMCD is correct to disallow the input tax claims and advise if, where the input tax claims have been validly disallowed by the RMCD, Star can claim an income tax deduction?

Your tax director has arranged a meeting with Reynold Lee next week. In preparation for that meeting, your tax director has requested you to carry out the following work:

(a) Investment proposal

Based on the investment profile provided by Star:

(i) Explain the differences between the two incentive claims (ITA and RA) in respect of the medical gowns, from the perspective of:

- the impact on the automation expenditure incurred in respect of surgical gloves;
- the utilisation of the allowance;
- the eligible qualifying capital expenditure in respect of both products, where applicable; and
- the incentive period.

(ii) Prepare calculations to illustrate the effect of the choice of incentive (ITA or RA) on Star's tax liabilities and based on your calculations, evaluate the two alternatives and advise as to which it would be preferable for Star to claim.

(b) IRB tax audit

Explain whether the IRB is authorised to carry out the proposed tax audit on Star for YAs 2013, 2014 and 2015.

(c) RMCD GST audit

State, with reasons, whether the RMCD is correct to disallow the three input tax claims and explain the corresponding income tax treatment.

Required:

Carry out the work as instructed by your tax director.

The following marks are available:

(a) Investment proposal:

(i) Differences between the investment tax allowance (ITA) and the reinvestment allowance (RA) incentives. (8 marks)

(ii) Evaluation, with supporting calculations, of the two incentives and advice on which to claim. (7 marks)

(b) Whether the Inland Revenue Board is authorised to carry out the proposed tax audit. (4 marks)

(c) The validity of the Royal Malaysian Customs Department's disallowance of the input tax claims and the corresponding income tax treatment. (6 marks)

(25 marks)

Section B – TWO questions ONLY to be attempted

3 DEF Sdn Bhd (DEF) owns and operates six international schools in Malaysia. On 1 April 2017, DEF disposed of all its approved (by the Minister of Education) school buildings to Edukasi REIT (ER), an existing real estate investment trust (REIT) approved by the Securities Commission and listed on Bursa Major, for RM12 million in cash. DEF had acquired the school buildings in 2010 for RM7 million.

Following their sale, DEF leased the school buildings from ER for RM800,000 per annum.

Of the RM12 million received by DEF:

– RM6·5 million was used to settle the outstanding borrowings on the school buildings, for which DEF paid interest of RM390,000 in the year of assessment (YA) 2017; and

– RM5·5 million was invested in the money market, which yielded DEF interest of RM465,000 in YA 2018.

Both DEF and ER make up their accounts to 31 March annually.

On 28 May 2018, ER distributed 92% of its total income for YA 2018. Extracts from ER's statement of profit or loss for the year ended 31 March 2018 are as follows:

	RM'000	RM'000
Rental		8,000
Interest		390
		8,390
Less:		
Trustees' remuneration	360	
Manager's remuneration	890	
Operating expenditure (all tax deductible)	2,500	
Depreciation	1,900	
		5,650
Profit before tax		2,740

ER's claim for capital allowances for YA 2018 is RM480,000.

Required:

(a) Explain the difference in the eligibility for industrial building allowance (IBA) of DEF Sdn Bhd and Edukasi REIT (ER) in respect of their periods of ownership of the approved school buildings. (2 marks)

(b) (i) State the tax treatment of DEF in each of the years of assessment 2017 and 2018 in respect of the interest and rental payments made, the claim for IBA and the interest income received. (4 marks)

(ii) Explain the effect on DEF's overall cash flow position as a result of the sale and lease-back of the school buildings. (3 marks)

(c) Compute ER's statutory income and chargeable income for the year of assessment 2018 and explain the significance of the distribution made on 28 May 2018. (6 marks)

(d) Explain how the distributions made by ER will be taxed and at what rate in the hands of (1) corporate unit holders who are resident in Malaysia; (2) individual unit holders who are resident in Malaysia; and (3) individual unit holders who are not resident in Malaysia. (5 marks)

(20 marks)

4 **(a)** On 1 November 2017, Cik Zaleha, a long-time employee of Bagus Bhd (Bagus), was granted an option to acquire 10,000 shares of Bagus, at RM1 per share. There was no stipulation as to a specific date or period within which she must exercise this option.

Zaleha acquired 4,000 shares on 4 December 2017, 2,500 shares on 10 February 2018 and the remaining 3,500 shares on 30 April 2018.

The first 6,500 (4,000 + 2,500) shares were new shares issued by Bagus, while the last 3,500 shares were acquired by Bagus on the open market on 1 April 2016 at RM1·50.

Bagus makes up its accounts to 31 December annually.

The movements in Bagus' share price were as follows:

	RM
1 November 2017	2·30
4 December 2017	4·00
10 February 2018	3·90
30 April 2018	1·00

Required:

(i) Compute the value of the share-based benefit which constitutes assessable income to Cik Zaleha for each of the years of assessment 2017 and 2018. (4 marks)

(ii) Explain whether Bagus Bhd is eligible for a tax deduction in respect of the shares acquired by Cik Zaleha; and if so, when the deduction may be taken and the amount of the deduction. (5 marks)

(b) On 2 January 2017, SiKaya Sdn Bhd (SiKaya), which makes up its accounts to 31 December annually, made interest-free general purpose loans to three of its directors as follows:

Director	Proportion of shares held by the director	Amount of loan RM'000	Source of funds/interest rate
Chairman	52%	800,000	Internal funds/0%
Managing director (MD)	19%	1,200,000	Internal funds/0%
Financial controller (FC)	Nil	500,000	External funds/6%

No repayment of any of the loans was made during 2017.

The average lending rate for the year 2017 was 6%.

Required:

(i) Explain the tax treatment of each of the loans from the perspective of SiKaya Sdn Bhd. (7 marks)

(ii) Compute the loan benefit, if any, which constitutes assessable income of each of the directors. (4 marks)

(20 marks)

5 Ladang Sdn Bhd (Ladang) owns 100 acres of plantation land. On 1 June 2010, Ladang granted a 40-year lease over 12 acres of land to Kilang Sdn Bhd (Kilang), for a premium of RM240,000 and an annual rent of RM12,000.

Kilang completed the construction of a factory on the leased land on 15 December 2010 at a cost of RM1,000,000. It immediately used the factory and all of the land in its manufacturing business.

On 1 June 2018, Kilang transferred the lease over five acres and the factory building sitting on the said land to Buatan Sdn Bhd (Buatan), for a premium of RM1,800,000 (RM1,200,000 for the factory building and RM600,000 for the land) and an annual rent of RM8,000. This sub-lease to Buatan is for the residual duration of the main lease to Kilang.

Kilang retained the balance of seven acres of the land for its own use in an orchard business commencing 1 June 2018.

The three companies are all unrelated and make up their accounts to 31 December annually.

Required:

(a) Compute the real property gains tax (RPGT) liability of Kilang Sdn Bhd on the disposal of the lease on 1 June 2018 over the five acres of land and factory building. (4 marks)

(b) Explain the RPGT compliance requirements for Buatan Sdn Bhd as the acquirer of a chargeable asset. (3 marks)

(c) Compute the balancing adjustment on the disposal of the factory building on 1 June 2018 from the perspective of Kilang Sdn Bhd. (5 marks)

(d) Explain the income tax treatment of the rental expense and rental income of Kilang Sdn Bhd (1) before the granting of the sub-lease; and (2) after the granting of the sub-lease to Buatan Sdn Bhd. (4 marks)

(e) Explain the income tax treatment of the premium of RM240,000 and the annual rent of RM12,000 in the hands of Ladang Sdn Bhd. (4 marks)

(20 marks)

End of Question Paper

1 Report to Aggresif Berhad

From Tax Firm
To Board of directors, Aggresif Berhad
Date June 2018

This report outlines the key tax issues relating to the divestment of the shares held in Hijau Teknologi Sdn Bhd (HTSB) as well as the sale and cessation of the furniture manufacturing business by Aggresif Berhad (AB). In addition, the report considers the tax implications on the returns from the proposed short-term investments to be made with the proceeds from the divestment/sale.

(i) Taxability of the gain on the sale of the shares in HTSB

AB acquired a 70% shareholding in HTSB on 15 July 2016 and sold this investment on 10 April 2018. The company made a gain of RM6·5 million (RM8m – RM1·5m) from the sale.

The arguments for treating this gain as a capital gain and thus not taxable are as follows:

– Whilst the business activities of AB consist of both investment holding and share dealing, the investment in HTSB was for a controlling stake in the company in order to facilitate entry into the green technology sector. This is further supported by the appointment of a director to the board of HTSB to monitor the progress of HTSB's business. This denotes the intention of AB to hold the shares for investment purposes.

– The sale of the shares in HTSB is part of the group's rationalisation exercise to divest its non-core businesses. As the green technology sector has not been identified as a core business, it was decided to sell the shares in HTSB. Therefore, it was not the original intention of AB to deal in the shares of HTSB to make profits. The sale was prompted by the move to focus on healthcare-related businesses. Furthermore, the sale came about because AB was presented with an attractive offer, not because it actively sought out a buyer.

However, there are also arguments for treating the gain as subject to income tax:

– The business activities of AB include share dealing, and the buying and selling of shares are part of its share-dealing activity. AB identified the opportunity to acquire HTSB and, thereafter, managed to secure the sale of the shares for a good profit.

– The holding period of the shares is relatively short, i.e. the shares were disposed of within two years.

– The shares were purchased using short-term funding in the form of a bank overdraft. This gives an indication that AB would be looking to sell the shares in order to repay the bank overdraft.

– AB was new to the green technology sector and did not have any related experience. Also, green technology did not really complement its existing businesses. This suggests an intention of holding the shares for a short time and looking for a quick resale to realise the gain.

On balance, the facts would appear to indicate that the shares in HTSB were acquired with the view to a quick resale. Therefore, the Inland Revenue Board (IRB) is likely to take the view that the gain arising therefrom should be revenue in nature and, hence, taxable.

(ii) Tax treatment of the sale of the furniture manufacturing assets

Sale of factory land and building, together with the permanently-affixed machinery
The factory land and building, together with the permanently-affixed machinery, were sold to a listed company, LC Berhad (LC), unrelated to AB. Following their acquisition, LC will then lease the assets to Good Furniture Sdn Bhd (GF).

No balancing adjustment is relevant to the factory land, as the land cost is not a qualifying expenditure and hence no industrial building allowance would have been claimed on this element of the cost.

The sale of the factory building together with the permanently-affixed machinery should be subject to the normal balancing adjustments. The balancing adjustment is calculated by comparing the sale consideration with the residual expenditure of the asset in question. This would be applicable to the factory building as well as the permanently-affixed machinery.

Sale of moveable plant and machinery
The moveable plant and machinery will be sold to another unrelated party, Happy Woods Sdn Bhd (HW). The agreement for the sale has been signed but is pending completion. The sale is expected to be completed in the year of assessment (YA) 2019 and in view of this the assets have been reclassified from property, plant and equipment to assets held for sale (AHFS).

Where in the basis period for a YA, a qualifying asset is classified as AHFS in accordance with the generally-accepted accounting principles and the asset is sold in the following basis period, such an asset shall be deemed to have ceased to be used in the following basis period. The disposal value of the asset shall be an amount equal to its market value at the end of the basis period such asset is held for sale or the net proceeds of the sale, whichever is greater [paragraph 61A(4), Schedule 3].

As the moveable plant and machinery is no longer in use at the end of the basis period for YA 2018, a notional allowance will be computed for YA 2018. In computing the balancing adjustments in the following basis period, i.e. for YA 2019, a notional allowance for YA 2019 should also be made in arriving at the residual expenditure amount [paragraph 61A(5), Schedule 3].

Tutorial note: *Paragraph 61A(5) has since been amended w.e.f. 30 December 2017 to the effect that notional allowance for YA 2019 would not be made.*

Sale of customer database

The customer database represents an intangible asset developed by AB for use in its furniture manufacturing business. Therefore, the sale of the customer database should be regarded as a capital transaction, and not subject to income tax.

A customer database is not eligible for capital allowance and, therefore, there is no requirement to compute a balancing adjustment on its sale.

(iii) The real property gains tax (RPGT) treatment of the sale of the factory land and building, together with the permanently-affixed machinery

The sale of the factory land and building will be subject to RPGT. The question then is whether the sale of the permanently-affixed machinery should be subject to RPGT.

For RPGT purposes, land is defined to include buildings on land and anything attached to land or permanently fastened to anything attached to land (whether on or below the surface). On the basis that the affixed machinery is permanently fastened to the building, it would also fall within the ambit of land, the disposal of which is subject to RPGT.

The chargeable gain or allowable loss on the disposal of the assets is determined by comparing the disposal price and acquisition price of the asset.

In this case, the disposal price is RM7 million, computed by taking the sale consideration of RM20 million (inclusive of the consideration for the affixed plant and machinery) and deducting the enhancement cost on the land, in this case, the factory construction cost of RM5 million and the cost of acquisition of the affixed plant and machinery of RM8 million. As the acquisition price of the land was RM9 million, this would give rise to an allowable loss of RM2 million. The loss can be carried forward to be set off against any future chargeable gains from the disposal of chargeable assets.

(iv) Tax payable for YA 2018

In order to illustrate the impact of the above treatments, we have prepared the company's income tax computation for YA 2018 (see the attached appendix). This shows that for YA 2018 AB will have chargeable income of RM6,630,000 and tax payable of RM1,591,200.

(v) Tax treatment of the return on the proposed short-term investments

The tax treatment of the returns on the three short-term investments can be analysed as follows:

Investment	Tax treatment
Bonds issued by the Government	The interest paid to AB in respect of the Government bonds is derived from Malaysia because it is paid by the Government of Malaysia. Although there is an exemption, it is not applicable to companies. Therefore, AB will be subject to tax in Malaysia on the interest income.
Short-term loan to Ace Sdn Bhd (Ace)	Ace is a resident of Malaysia, and it utilised the borrowing to acquire a property to produce Malaysian rental income. Therefore, the interest income received by AB is derived from Malaysia, and will be subject to tax in Malaysia [s.4c].
Short-term loan to Best Sdn Bhd (Best)	As Best is a Singapore company and the funds borrowed will be used for its Singapore trading business, the interest income derived therefrom can be regarded as a foreign income to AB and, therefore, exempt from Malaysian income tax when received in Malaysia.

------- **End of report** ---------

Appendix

Aggresif Berhad (AB)
Income tax computation for YA 2018

	RM'000	RM'000
Profit before depreciation and taxation		10,500
Less:		
Dividend income		(6,000)
Gain from disposal of HTSB shares		(6,500)
Gain from sale of furniture manufacturing assets		(4,000)
Add:		
Loss from the trading of portfolio shares		200
Staff redundancy costs due to the cessation of business		1,500
Commission for sale of shares in HTSB		800
Other expenses (post cessation expenses)		500
Adjusted business income		Nil
Adjusted loss (RM3,000,000)		
Add: Balancing charge		3,330
Statutory income from furniture manufacturing business		3,330
Gains from the disposal of HTSB shares	6,500	
Less commission on sales of shares	(800)	
Less loss from trading of portfolio shares	(200)	
Statutory income from share dealing		5,500
Dividend income (exempt)		Nil
Aggregate income		8,830
Less current year loss		(3,000)
Total income/chargeable income		5,830
Tax payable at 24%		RM1,399,200

Working: Capital allowance and balancing adjustment calculation

	RM'000	RM'000
Land (not qualifying expenditure)		Nil
Factory building		
Cost of acquisition	5,000	
– Initial allowance [10% x RM5m]	(500)	
– Annual allowance YA 2013 to YA 2017 [5 yrs x 3% x RM5m]	(750)	
	3,750	
Sale consideration	(6,000)	
Balancing charge (restricted to actual allowance claimed)	2,250	1,250
Affixed machinery		
Cost of acquisition	8,000	
– Initial allowance [20% x RM8m]	(1,600)	
– Annual allowance YA 2014 to YA 2017 [4 yrs x 14% x RM8m]	(4,480)	
	1,920	
Sale consideration	(4,000)	
Balancing charge	2,080	2,080
Moveable machinery		
Assets ceased to be used on 2 May 2018, no capital allowance claimed		Nil
The assets were classified as assets held for sale in YA 2018 but the sale will not be completed until after 31 May 2018, so the balancing adjustment calculation will only be made in YA 2019		Nil
Customer database		Nil
		3,330

2 Star Manufacturing Sdn Bhd (Star)

(a) Investment proposal

(i) Differences between the investment tax allowance (ITA) and reinvestment allowance (RA) incentives

Star is right that both the ITA and RA accord an allowance based on 60% of the qualifying expenditure incurred. The differences between the two incentives which are relevant to the proposed investment profiles are as follows:

– **Impact on automation expenditure** – ITA, if approved, will only be given to the manufacture of medical gowns and not for the manufacture of surgical gloves. Any capital expenditure incurred for the production of surgical gloves will not be entitled to ITA.

However, in the case of RA, so long as a company undertakes a qualifying project, it will be eligible for the incentive. Therefore, if Star wishes to continue with the RA claim, the proposed diversification into the production of medical gowns should constitute a qualifying project; and in addition, it will also be able to avail of RA in respect of the automation. Hence, the proposed diversification into medical gowns as well as the automation project in respect of surgical gloves would avail of the RA incentive.

As the ITA and RA are mutually exclusive, it is not possible for Star to claim ITA in respect of medical gowns and RA in respect of surgical gloves. Therefore, if Star opts to apply for ITA, the proposed automation project of RM3·5 million in respect of surgical gloves in YA 2020 cannot avail of any tax incentive.

– **Utilisation of the allowance** – Both the ITA and RA incentives can be used to set off up to 70% of the statutory income of the company. Where the ITA is granted, separate accounts would need to be maintained and the ITA can only be used to set off against up to 70% of the statutory income in respect of the production of medical gowns. The ITA cannot be used to set off against the statutory income from the production of surgical gloves. However, the RA incentive can be set off against the combined statutory income of the production of both surgical gloves and medical gowns.

– **Eligible qualifying capital expenditure** – For both incentives, only capital expenditure relating to the factory and plant and machinery is eligible for an incentive claim. However, the definition of a factory and plant and machinery for the purposes of an RA claim is more restrictive compared to an ITA claim. For example, where the factory area includes space for storage, the area for storage is only allowed for the RA incentive if it is less than 10% of the total floor area. Such a restriction is not applicable for the ITA incentive. In the present case, as 20% of the factory will be used for the storage of raw materials, under the RA incentive, only 80% of the factory building cost, i.e. RM4 million (80% x RM5 million), will be eligible.

In addition, capital expenditure incurred to replace existing assets is not eligible for the RA incentive but can avail of ITA so long as it relates to the production of a promoted product. In the case of Star, the proposed capital expenditure of RM2 million to replace existing machinery in YA 2021would not qualify for RA but would be eligible for an ITA claim.

– **Incentive period** – RA is given for a period of 15 years of assessment (YAs) from the first YA the company first claimed the incentive. As Star first claimed the RA in YA 2014, the company can continue claiming RA until YA 2028. On the other hand, ITA is given for a period of five years from the date the company incurred its first qualifying capital expenditure. As the construction of the factory will commence in July 2018, the ITA incentive period will be from July 2018 to June 2023. During the period in which ITA is claimed, Star will not be eligible to claim RA. However, this does not extend the overall RA period, i.e. during the ITA relief period, the RA qualifying period continues to be counted.

(ii) Evaluation of the two tax incentives

Computation of tax liabilities

(1) Star opts to apply for ITA in respect of the production of medical gowns

Year of assessment	2019 RM'000	2020 RM'000	2021 RM'000
Medical gowns business			
Statutory income (SI)	500	3,000	3,000
Less: ITA (see working 1)	(350)	(2,100)	(2,100)
	150	900	900
Surgical gloves business			
SI	4,000	6,000	6,000
Aggregate/chargeable income	4,150	6,900	6,900
Tax liability at 24%	996	1,656	1,656
Total tax liability			4,308

Working 1

Year of assessment	**2019**	**2020**	**2021**
	RM'000	**RM'000**	**RM'000**
Current year ITA			
Qualifying expenditure	11,000	–	2,000
ITA at 60%	6,600		1,200
Balance brought forward	–	6,250	4,150
	6,600	6,250	5,350
Utilisation (restricted to 70% of SI)	(350)	(2,100)	(2,100)
Balance carried forward	6,250	4,150	3,250

(2) **Star opts to continue with RA**

Year of assessment	**2019**	**2020**	**2021**
	RM'000	**RM'000**	**RM'000**
SI			
Medical gowns	500	3,000	3,000
Surgical gloves	4,000	6,000	6,000
	4,500	9,000	9,000
Less: RA (see working 2)	(3,150)	(4,950)	–
Aggregate/chargeable income	1,350	4,050	9,000
Tax liability at 24%	324	972	2,160
Total tax liability			3,456

Working 2

Year of assessment	**2019**	**2020**	**2021**
	RM'000	**RM'000**	**RM'000**
Current year RA			
Qualifying expenditure		–	2,000
Factory (80% of RM5 million)	4,000		
Plant and machinery	6,000	3,500	Nil
	10,000	3,500	Nil
RA at 60%	6,000	2,100	Nil
Balance brought forward	–	2,850	Nil
	6,000	4,950	Nil
Utilisation (restricted to 70% of SI)	(3,150)	(4,950)	Nil
Balance carried forward	2,850	Nil	Nil

Evaluation

Based on the above calculation, if Star opts to apply for ITA, the estimated tax liability for YAs 2019 to 2021 is RM4,308,000 with an unabsorbed ITA balance of RM3,250,000 which can be carried forward to be utilised against future statutory income from the production of medical gowns. If Star continues with the RA incentive, the tax liability is only RM3,456,000 and there is no unabsorbed allowance to be carried forward.

There are two reasons for this difference:

The RA incentive allows the allowance to be set off against the combined statutory income from both medical gowns and surgical gloves.

The eligible expenditure for ITA is only RM13 million, as opposed to RM13·5 million of eligible expenditure for RA.

Based on the above, Star should continue claiming the RA incentive instead of applying for the ITA incentive for the production of medical gowns.

Tutorial note: *Not directly required in the question above, but just for completeness, it should be noted that there is another difference between RA and ITA relating to the clawback of the incentive. If RA was claimed and there is a disposal of the relevant asset within five years from the date of its acquisition, the RA would be withdrawn. If ITA was claimed, the clawback would apply only if the asset was disposed of within two years from the date of its acquisition.*

(b) Inland Revenue Board (IRB) tax audit

Star has been the subject of a tax investigation and as a result, a composite assessment for YAs 2011 to 2013 has been issued. Notwithstanding the recent tax investigation, there is nothing to stop the IRB from carrying out a tax audit on the company.

However, while the IRB can request documentation relating to YA 2013 as part of its audit, as a composite assessment has been issued for YA 2013, that assessment is regarded as final and conclusive [pursuant to s.96A(6)] for the purposes of the

Income Tax Act and the IRB would, under normal circumstances (see tutorial note below), not raise any additional assessment for YA 2013 thereafter. Such a restriction does not apply to YAs 2014 and 2015. Therefore, the IRB can still raise assessments and additional assessments for those YAs if there is any understatement of taxable income.

Tutorial note: *It is understood that, although not common, in practice the DGIR has re-opened years of assessment previously covered in a composite assessment, if he is of the view that there is a new discovery of non-disclosure on the part of the taxpayer.*

(c) Royal Malaysian Customs Department (RMCD) goods and services tax (GST) audit

Purchase of a passenger car for use by the managing director – RM12,000
A claim for input tax incurred on the purchase of a passenger car is specifically blocked. Therefore, the RMCD is correct in not allowing Star to claim an input tax credit on this amount.

As Star is not allowed to claim an input tax credit for GST purposes, the input tax incurred is allowed for income tax purposes.

Purchase of raw materials for surgical gloves, issued in the name of a shareholder – RM20,000
The input tax incurred on the purchase of raw materials should be allowed as an input tax credit as it was incurred in the furtherance of the provision of a taxable supply (i.e. the sale of surgical gloves). However, as the tax invoice was issued in the name of the shareholder and not in the name of the company, this will have invalidated the claim for an input tax credit. Therefore, the RMCD is correct in not allowing Star to claim the input tax credit unless Star can obtain a revised tax invoice, issued to the name of the company.

From an income tax perspective, as Star would have been entitled to a credit for the input tax in its GST return had a valid tax invoice been obtained, the input tax should not be allowed as an income tax deduction.

Purchase of hampers as free gifts to customers where no deemed output tax was accounted for – RM5,000
Star has purchased hampers to be given as free gifts to its customers. On the basis that the free gifts were given for the furtherance of the company's taxable supply, the input tax on their purchase should be allowed as an input tax credit in the GST return, notwithstanding that the deemed output tax has not been accounted for. The RMCD should have deemed a corresponding output tax on Star instead of disallowing its input tax claim.

For income tax purposes, since Star is entitled to an input tax credit on the purchase of the hampers, no income tax deduction would be given. Also, the deemed output tax borne by the company in respect of the free gifts is not allowed as a tax deduction as this is specifically prohibited under the income tax legislation.

3 DEF Sdn Bhd (DEF) and Edukasi REIT (ER)

(a) Eligibility for industrial building allowance (IBA)

DEF owned and operated the approved school buildings as international schools. Therefore, it qualified for IBA [paragraph 42B, Schedule 6].

ER owns the buildings but lets them for rent to DEF to be used as schools. ER is therefore specifically prohibited from qualifying for IBA [paragraph 16B, Schedule 3].

(b) (i) DEF tax treatment for the years of assessment (YAs) 2017 and 2018

	YA 2017	YA 2018
Rental deduction	Nil	RM800,000
Interest deduction	RM390,000	Nil
Claim for IBA at 10%	RM700,000	Nil
Interest income assessable	Nil	RM465,000

(ii) DEF effect on overall cash flow position

For YA 2017, DEF's outflow of cash is RM390,000.

For YA 2018, there is a net outflow of cash of RM335,000 (RM800,000 – RM465,000).

However, DEF's overall cash flow position has improved because, instead of owing RM6·5 million, the company is now debt free and holding a cash balance of RM5·5 million.

(c) ER – Statutory income and chargeable income for YA 2018

	RM'000	RM'000
Rental		8,000
Less:		
Trustees' remuneration	nil	
Manager's fees	(890)	
Operating expenditure (all tax deductible)	(2,500)	
Depreciation	nil	
		(3,390)
Adjusted income		4,610
Less: Capital allowances		(480)
Statutory income rental		4,130
Add: Statutory income interest		390
Aggregate/total income		4,520
Less: Exempt amount (100%)		(4,520)
Chargeable income		Nil

Where a real estate investment trust (REIT) distributes 90% or more of its total income to its unit holders within two months after its financial year end, then 100% of the total income of the REIT is exempt from tax [s.61A(1)]. ER distributed 92% of its total income on 28 May 2018, which is less than two months after its year end of 31 March 2018.

(d) Tax treatment of distributions received from ER

(1) Corporate unit holders resident in Malaysia
In the case of corporate unit holders resident in Malaysia, ER will pay the gross distribution amount in full without any withholding tax at source. The recipient company will have to report such a distribution gross in its annual tax return. The tax rate applicable to such a REIT distribution is the standard rate of 24% or a combination of the 18% and 24% rates depending on whether the recipient company is an SME (small and medium enterprise) as defined.

(2) Individual unit holders resident in Malaysia
In the case of a resident individual, ER is required to withhold tax at the rate of 10% at source from the distribution and pay over the tax withheld to the Director General within one month after the date of the distribution. The individual is not required to report the distribution in their annual tax return. Therefore, the 10% tax withheld represents the final tax on the REIT income for the individual unit holder.

(3) Individual unit holders not resident in Malaysia
The tax treatment of distributions by REITs to individual unit holders who are non-resident in Malaysia is identical to that for individual unit holders who are so resident, i.e. 10% withholding tax at source as the final tax.

4 (a) Cik Zaleha – share options

(i) Share based benefit

	RM	RM
Year of assessment (YA) 2017		
4,000 shares at RM4 each	16,000	
Less: Paid by Zaleha	(4,000)	
Value of taxable benefit	12,000	
Total value of taxable benefit		12,000
YA 2018		
2,500 shares at RM3·90 each	9,750	
Less: Paid by Zaleha	(2,500)	
Value of taxable benefit	7,250	
3,500 shares at RM1·00 each	3,500	
Less: Paid by Zaleha	(3,500)	
Value of taxable benefit	Nil	
Total value of taxable benefit		7,250

(ii) Deductibility to Bagus Bhd (Bagus)

Bagus issued 6,500 new shares to facilitate the first two exercises by Zaleha. Bagus did not incur any expense on these newly-issued shares. Therefore, no tax deduction is available to Bagus.

The final exercise by Zaleha of 3,500 shares was satisfied by treasury shares, which cost Bagus RM5,250 (3,500 x RM1·50). This expenditure is deemed to have been incurred when the shares were issued to Zaleha on 30 April 2018, i.e. in YA 2018 [s.34D], even though the treasury shares were actually acquired by Bagus in YA 2016. The deduction available to Bagus is RM1,750, i.e. net of the RM3,500 paid by Zaleha.

(b) Sikaya Sdn Bhd (Sikaya) – Loans to directors

(i) Tax treatment of SiKaya

Loan to chairman
The chairman holds more than 20% of the ordinary share capital of SiKaya, and the loan of RM800,000 was sourced from internal funds. The anti-avoidance provision [s.140B] deems that SiKaya has derived interest income at the average lending rate on this loan of RM48,000 (RM800,000 x 6%) in YA 2017.

This RM48,000 must be treated as interest income [under s.4(c)] by SiKaya as it is specifically excluded as business income [s.4B].

Loan to managing director (MD)
This loan is not caught under the anti-avoidance provision [s.140B] despite it being sourced from internal funds, because the MD only holds 19% of the ordinary share capital of SiKaya.

There is no interest expense incurred by SiKaya in respect of this loan, neither will there be any deemed interest income to the company. Therefore, there will be neither a deduction nor any deemed income on SiKaya in respect of the loan to the MD.

Loan to financial controller (FC)
The FC, although a director of SiKaya, does not own any shares in the company, hence the anti-avoidance provision [s.140B] does not apply. The interest incurred of RM30,000 (RM500,000 x 6%) in YA 2017 may be argued to be a staff benefit and, therefore, as tax deductible to SiKaya.

Alternative answer: *An alternative argument would be that the interest is incurred for a non-business purpose and only attributable to any interest earned on the loan to the employee. In this case, as there is no interest earned, the ability to deduct the interest expense of RM30,000 would be effectively lost to SiKaya. Candidates who answered on the basis of this alternative were awarded equal marks.*

(ii) Loan benefit assessable on the directors

Chairman
The anti-avoidance provision [s.140B] operates such that the company is deemed to have derived interest income from the loan to the Chairman at the market rate.

It follows that the Chairman may be correspondingly deemed to have paid interest on the loan given to him at the market rate.

Therefore, it may be argued that Chairman did not derive any taxable benefit re the loan.

Alternatively: As for MD – there is no taxable benefit because the loan was sourced from internal funds.

Managing director (MD)
As an employee of SiKaya, the interest-free loan to the MD constitutes a benefit with a quantifiable monetary benefit. However, no value will be attributed to the benefit as the loan was sourced from the internal funds of SiKaya. Therefore, there is no taxable benefit to the MD.

Financial controller (FC)
The interest-free general purpose (i.e. not for housing, car or education) loan to the FC also represents a taxable benefit to the employee. As in this case the loan is sourced from external funds at 6% interest, the interest expense incurred by SiKaya for YA 2017 of RM30,000 will be the value of the loan benefit assessable on the FC for YA 2017.

Tutorial note: *If the loan had been for housing, car or education, there would have been an exemption of the interest attributable to the loan of up to RM300,000.*

5 Kilang Sdn Bhd (Kilang)

(a) Real property gains tax (RPGT) on the disposal of lease by Kilang

	RM	RM
Disposal consideration of the lease	1,800,000	
Less: Enhancement cost – factory building	(1,000,000)	
Disposal price		800,000
Acquisition consideration:		
For the five acres (5/12 x 240,000) RM100,000		
Pro-rated over the residual years (RM100,000 x (40 – 8)/40)		(80,000)
Chargeable gain		720,000
Acquisition date 1 June 2010		
Disposal date 1 June 2018		
Disposal in the ninth year		
RPGT at 5%		36,000

(b) Compliance requirements of Buatan Sdn Bhd (Buatan)

As the acquirer of the chargeable asset, namely the lease of the five-acre land and factory building, Buatan must withhold 3% of the disposal consideration of RM1,800,000, i.e. RM54,000 and pay over the amount to the Inland Revenue Board (IRB) within 60 days after the disposal date, i.e. by 31 July 2018.

Buatan also has to furnish an RPGT return in the prescribed form to notify the IRB of the acquisition within 60 days of the disposal date, i.e. by 30 July 2018.

(c) Balancing adjustment on the disposal of the factory building by Kilang

	RM	RM
Qualifying building expenditure on 15 December 2010		1,000,000
YA 2010		
Initial allowance 10% + annual allowance 3%	(130,000)	
YA 2011 to YA 2017		
Annual allowance (3% x 7 years)	(210,000)	
Total allowances claimed		(340,000)
Residual expenditure		660,000
Factory building disposal proceeds		(1,200,000)
		(540,000)
Balancing charge restricted to actual allowances granted		340,000

(d) Income tax treatment of rental expense and rental income

Before the sub-lease
Kilang pays RM12,000 a month to Ladang Sdn Bhd (Ladang) for the lease of the 12 acres of land which it used in its manufacturing business. The rental expense is therefore fully deductible against the income from this manufacturing business.

After the sub-lease
Kilang sub-leased five acres to Buatan for a monthly rental of RM8,000. In turn, Kilang continues to pay RM12,000 to Ladang, of which RM5,000 (5/12 x RM12,000) relates to the sub-leased land. The RM5,000 is therefore deductible against the rental income received from Buatan of RM8,000.

The remaining RM7,000 of the rental expense will be deductible against the gross income from the orchard business.

(e) Income tax treatment of premium and annual rent received by Ladang

The RM240,000 represents a sum for the granting of a right to use the land to Kilang. The land is a fixed asset of Ladang, therefore, the payment of RM240,000, which is in substance a premium, is capital in nature and as such, not subject to income tax.

The annual rent of RM12,000 is for the use of the land, therefore revenue in nature. It represents income to Ladang and as such is duly subject to income tax [under s.4(d)].

			Marks
1	**(i)**	**Tax treatment of gain on sale of HTSB shares**	
		Argument for capital treatment (1·5 each)	3
		Argument for revenue treatment (1 each)	4
		Conclusion	1
		Available	8
		Maximum	6
	(ii)	**Income tax treatment of sale of furniture manufacturing assets**	
		All sales made to unrelated companies	0·5
		Land	
		– no balancing adjustment issue, NQE	1
		Factory building	
		– Balancing adjustment applies	1
		Affixed machinery	
		– Balancing adjustment also applies	1
		Moveable plant and machinery	
		– Treatment of AHFS	2
		– Timing of balancing adjustment YA 2019	0·5
		– Application of notional allowances for residual expenditure purposes	1
		Customer database	
		– Use in business, capital	1
		– No balancing adjustment because no CA	1
		Available	9
		Maximum	8
	(iii)	**RPGT treatment of sale of factory**	
		Treatment of permanently-affixed machinery	1
		Determination of disposal price of RM7 million	2
		Acquisition price of RM9 million	0·5
		Identification of allowable loss of RM2 million	0·5
		Treatment of allowable loss	1
		Available	5
		Maximum	4
	(iv)	**Income tax computation**	
		Tax adjustments:	
		Dividend income	0·5
		Gain from sale of HTSB shares	0·5
		Gain from sale of furniture manufacturing assets	0·5
		Loss from trading of portfolio shares	0·5
		Staff redundancy costs due to cessation of business	0·5
		Commission for sale of shares in HTSB	0·5
		Post cessation expenses	0·5
		Both adjusted business income and statutory income from furniture business correctly identified	0·5
		Statutory income from share dealing (3 x 0·5)	1·5
		Dividend income exempt	0·5
		Current year loss deducted from aggregate income	0·5
		Calculation of CAs/balancing charge	
		– factory building	1·5
		– affixed machinery	1
		– No adjustment for sale of moveable machinery (2 x 0·5)	1
		– No adjustment for sale of customer database	0·5
		Tax liability	0·5
		Available	11
		Maximum	9

		Marks
(v) Tax treatment of return on short-term investments		
Government bonds		1·5
Loan to Ace		2
Loan to Best		2
	Available	5·5
	Maximum	4
Professional marks		
Format and presentation of the report		1
Clarity and effectiveness of communication including logical flow		2
Appropriate use of appendix		1
		4
		35

	Marks
2 (a) Investment proposal	
(i) Differences between ITA and RA	
Impact on automation expenditure:	
– ITA on gowns only	1
– RA can be for both	1
– Cannot claim ITA and RA for different projects at the same time	1
Utilisation of allowance:	
– ITA requires separate accounts	1
– RA on combined basis	1
Eligible QCE:	
– Storage space restriction	1
– Replacement expenditure	1
Incentive period:	
– RA period	1
– ITA period	1
– If claim ITA, RA period will continue to run	0·5
Available	9·5
Maximum	8
(ii) Evaluation of the two tax incentives	
Calculations:	
ITA:	
– QE: factory, plant and machinery and replacement machinery	0·5 + 0·5 + 0·5
– 60% allowance, 70% restriction against gowns only	0·5 + 0·5
– Tax liability	0·5
RA:	
– QE: factory exclude storage, automation asset, not for replacement	0·5 + 0·5 + 0·5
– 60% allowance, 70% restriction against combined income	0·5 + 0·5
– Tax liability	0·5
Evaluation comments:	
Summary of calculation results	0·5
Reasons for differences (2 x 0·5)	1
Conclusion: continue with RA	0·5
Available	8
Maximum	7
(b) IRB tax audit	
Cannot stop IRB tax audit, including for YA 2013	1 + 0·5
Composite assessment final and conclusive, no additional assessment possible for YA 2013	1 + 1
YA 2014 and 2015 – still open, can issue assessments/additional assessments	1
Available	4·5
Maximum	4
(c) RMCD GST audit	
Passenger car:	
Blocked – no ITC, allowable for income tax purposes	1 + 0·5
Raw materials:	
– Not allowed to claim ITC as no valid tax invoice	1
– Eligible to claim if tax invoice in name of company, income tax not tax deductible	1 + 1
Hampers	
– ITC allowed, RMCD should have deemed output tax instead	1 + 1
– ITC not allowed for income tax deduction	0·5
– Deemed output tax specifically prohibited for income tax deduction	1
Available	8
Maximum	6
	25

				Marks
3	**(a)**	**Eligibility for IBA**		
		By DEF, eligible, reason		0·5 + 0·5
		By ER, not eligible, reason		0·5 + 0·5
				2
	(b)	**(i)** **Comparative tax treatment**		
		Rental deduction (2 x 0·5)		1
		Interest deduction (2 x 0·5)		1
		Claim for IBA		1 + 0·5
		Interest income (2 x 0·5)		1
			Available	4·5
			Maximum	4
		(ii) **Cash flow effect**		
		Outflows of cash on revenue account (2 x 1)		2
		Capital position much improved, debt free, substantial cash balance (3 x 0·5)		1·5
			Available	3·5
			Maximum	3
	(c)	**Computation of statutory and chargeable income**		
		Adjustments:		
		Trustees' remuneration		1
		Managers' fees		1
		Operating expenditure		0·5
		Depreciation		0·5
		CAs		0·5
		Identification of statutory income rental and interest		0·5
		100% exemption		0·5
		Chargeable income nil		0·5
		Explanation: >90% total income, distributed within two months		1 + 1
			Available	7
			Maximum	6
	(d)	**Tax treatment of unit holders**		
		Resident company		1 + 1
		Resident individual		1 + 1
		Non-resident individual		1
				5
				20

				Marks
4	(a)	(i)	**Share based benefit**	
			YA 2017 – value of assessable benefit	1 + 0·5
			YA 2018 – 2,500 shares: value of assessable benefit	0·5 + 0·5
			3,500 shares: value of assessable benefit	1 + 1
			Available	4·5
			Maximum	4
		(ii)	**Deductibility to Bagus**	
			New shares issued: no deduction, reason	1 + 1
			Treasury shares issued: deduction, amount	1 + 0·5
			When acquired by Zaleha, YA 2018 not YA 2016	1 + 0·5
				5
	(b)	(i)	**Tax treatment of SiKaya**	
			Loan to chairman	
			– Anti-avoidance provision applies, >20% shareholding, internal funds	0·5 + 1 + 1
			– Deemed interest income, amount	1 + 0·5
			– Specifically excluded from business income	0·5
			Loan to managing director:	
			Not caught, holding <20%	0·5 + 0·5
			No deduction, no deemed interest	0·5 + 0·5
			Loan to financial controller:	
			Not caught, not a shareholder	0·5
			Interest incurred deductible as a staff benefit	1
			Available	8
			Maximum	7
		(ii)	**Tax treatment of directors**	
			Chairman: no comparable anti-avoidance provision, no interest incurred	1 + 0·5
			Managing director: quantifiable monetary benefit, but nil value	1 + 0·5
			Financial controller: quantifiable monetary benefit, assessable amount	1 + 1
			Available	5
			Maximum	4
				20

		Marks
5 (a) RPGT computation on disposal of lease		
Disposal consideration – correct amount		0·5
Enhancement cost – correct amount, correct stage		0·5 + 0·5
Acquisition consideration, pro-rated by reference to area and duration		1 + 1
Correct determination of holding period and correct rate of tax		0·5 + 0·5
	Available	4·5
	Maximum	4
(b) Compliance requirements for acquirer		
Retention of 3% and amount		0·5 + 0·5
Pay over to IRB within 60 days		0·5 + 0·5
Furnish acquirer's return and time line		0·5 + 0·5
		3
(c) Balancing adjustment on disposal of factory building		
Correct qualifying building expenditure		0·5
YA 2010, initial allowance 10%, annual allowance 3%		0·5 + 0·5 + 0·5
YA 2011 to YA 2017, 7 years, 3%		0·5 + 0·5
Disposal – correct amount		1
Balancing charge restricted to the actual allowances given		1
		5
(d) Income tax treatment of rental expense and rental income		
Before sub-lease		1 + 0·5
After sub-lease		
– Apportioned amount of RM5,000 re sub-leased area, related to rental income		1 + 1
– Balance related to orchard business		1
	Available	4·5
	Maximum	4
(e) Income tax treatment of premium and annual rent		
Premium: for granting a right to use land, a fixed asset		0·5 + 0·5
capital in nature, not taxable		1 + 0·5
Annual rent: for use of land, revenue in nature, taxable as rental income		0·5 + 1 + 0·5
	Available	4·5
	Maximum	4
		20

Examiner's report
P6 Advanced Taxation (MYS)
March 2018

ACCA

General Comments
The examination comprised two sections. Section A contained two compulsory questions, question 1 for 35 marks and question 2 for 25 marks. Section B comprised three further questions of 20 marks each, from which candidates were required to answer two questions.

Most candidates attempted all four questions required, although there were often parts of questions left unanswered. There was no evidence of time pressure; any unanswered parts appeared to be due to insufficient knowledge or insufficient preparation, as opposed to time pressure.

Specific Comments

Question One
This question required the candidates to consider several different areas.

Part (i) required candidates to argue in favour of two activities being treated as a single business source rather than two separate business sources. Some candidates did not read the requirement closely and presented arguments for treating the activities as a single source as well as two separate sources.

Part (ii) dealt with the assessability of a receipt of compensation. Some candidates wrote about badges of trade, which was incorrect.

Part (iii) tested candidates' understanding of agriculture allowances. This was reasonably well done.

Part (iv) presented two scenarios regarding foreign currency exchange gains. Many candidates did not explain why one was revenue in nature and realised, while the other was capital and unrealised. Surprisingly, candidates appeared to have not grasped the basics in this area, i.e. trade versus non-trade transaction, realised versus unrealised.

Part (v) tested the availability of GST input credits under four different situations. Many candidates did not specifically answer the requirement. Instead, they merely wrote what they knew about GST as a topic.

Question Two
This question consisted of two separate and fairly autonomous parts.

Part (a) of the question required the application of the venture capital tax incentive measure and part (b) related to real property gains tax (RPGT).

In part (a), many candidates wrote at length about the requisites and conditions for eligibility for the incentive when the facts of the scenario stated that the company did qualify. What was required was an explanation of the mechanism of the incentive and calculations to demonstrate how the incentive measure worked.

Part (b) relating to RPGT was generally well answered.

Question Three

Question 3 related to the tax treatment of two specific business entities, a company and a limited liability partnership, and specifically the impact of the different types of entity on the entity itself and also the shareholders. A second topic examined in this question related to basis periods on commencement of operations, the impact on compliance requirements and the claim for capital allowances.

This question was not often selected by candidates. Amongst those candidates who did select it, performance was reasonably good.

Question Four

This question tested residence of an individual, withholding tax, stamp duty, and tax treatment of the form and return from investments, as well as disposal of investments.

This question was generally well answered.

Question Five

This question was comprised of two separate autonomous parts, part (a) on the taxation of an award, bonus and the deductibility of the bonus, and part (b) relating to the taxation of a deceased estate.

In part (a), the arguments for and against the assessability of an award received by an employee, and the deductibility of a bonus for an employer were not well handled by many candidates.

Part (b) relating to the taxation of a deceased estate, the beneficiary and the executor was generally well-answered.

Examiner's report

P6 Advanced Taxation (MYS)
June 2018

General Comments
The examination consisted of two sections. Section A contained Q1 for 35 marks and Q2 for 25 marks, both questions being compulsory. Section B contained three questions of 20 marks each, from which candidates had to answer two questions.

With rare exceptions, candidates attempted all four questions. There was little evidence of time pressure. Where questions were left unanswered by candidates, this appeared to be due to lack of preparation or poor exam technique, rather than insufficient time.

Specific Comments

Question One
This question is based on a listed company with multiple business activities. It tested the candidates ability to present arguments for both capital and revenue nature of gains from the disposal of shares in a subsidiary, issues arising from the winding down of its original core manufacturing business, and the tax treatment of returns from the short-term investment of excess cash. Candidates were guided on the areas to focus on in the scenario facts and the question requirements.

Part (i) requires cogent arguments for capital and revenue nature of the gains from the sale of the shares in the subsidiary. Candidates were required to examine the facts and form their arguments. Merely repeating the facts without forming conclusions with them did not earn marks.

Part (ii) involves the fundamental aspects of the income tax treatment when assets used in a business activity were disposed of. Many candidates read "land and buildings" and plunged into Real Property Gains Tax (RPGT) implications despite the requirement clearly asking for "income tax treatment" for the sale of the assets. In this part, assets "held for sale" in the current year but not sold was broached, but the cue was rarely picked up by candidates.

When Part (iii) directed candidates' attention to the RPGT treatment of the sale of the land, factory and permanently-affixed machinery, a good many candidates treated them as three separate chargeable assets. They had overlooked the fundamental RPGT concept that the land is the real property and that the building and the permanently-affixed machinery are enhancements of the land.

Part (iv) asked for the tax computation of a company with multiple business sources, dividend income, current year loss, and the application of the appropriate tax rate, all of which are fundamental tax aspects. Many candidates did not do well in this.

Part (v) relating to short-term investment returns, testing the derivation and taxation of interest income, was generally well answered.

If a candidate keeps a cool head, reads the requirements carefully and closely, recalls the fundamental tax principles and applies them to the scenario given, he or she should be able to garner many of the 35 marks in Q1.

Question Two
Part (a) deals with a well-established company on the verge of diversifying its existing manufacturing business. The company needed advice on whether to claim the investment tax allowance (ITA) or the reinvestment allowance (RA) in view of its impending capital expenditure on the new product, on the automation of its existing production, and the replacement of its existing machinery. Many candidates promptly reproduced all they knew about the eligibility and mechanism of both ITA and RA without considering how these were relevant to the given scenario. This part was poorly answered.

Part (b) examined the tax administrative aspects of a composite assessment for a year of assessment (YA), and now a proposed tax audit on the same YA. Many candidates wrote at length on the time bar aspect rather than the overlapping audit/investigation action on the same YA.

Part (c) related to the claim of input tax credits under the Goods and Services Tax (GST) Act and its corresponding treatment under the Income Tax Act. This part was satisfactorily responded to.

Question Three
This question comprises four separate parts, all of which were generally well answered.

Part (a) dealt with the current issue of only owner-operators being allowed to claim industrial building allowances (IBA) for deemed industrial buildings. Many candidates appeared to be completely unaware of this trending issue. In fact, some answers even featured the long-gone 2% rate for IBA, which leads one to conclude that candidates are not learning the updated tax laws.

Part (b) relates to the changed circumstances of owning *vis-a-vis* leasing the business premises and the attendant tax implications and the impact on the cash flow situation of the company. This part was well answered.

Part (c) requires the tax computation for a real estate investment trust (REIT). This part was well responded to.

Part (d) requires candidates to state the tax treatment of the REIT distributions in the hands of the unit-holders. Unexpectedly, this part was poorly answered.

Question Four
Part (a) relates to the tax treatment of share-based remuneration, both from the employee's and employer's perspectives. Many candidates used the average price method when the question clearly stated that there was no stipulation as to the option period. They lost marks as a result. The employer's ability to claim a tax deduction for the shares was also not very well answered.

Part (b) of this question deals with interest-free loans to the directors of a company. The deemed-interest-income treatment to the company appears to be better-understood now. However, some candidates did not know that the chairman and the managing director are in fact directors of the company as well as the employees of the company. The tax treatment of the employees who receive interest-free loans is not well-understood.

Question Five

This question tests comprehensively the aspects of lease, sub-lease, premium, rental expense and rental income, RPGT and income tax treatment on the disposal of a factory building, and the RPGT compliance requirements for an acquirer of chargeable asset.. This question was satisfactorily answered. Some aspects to note are:

- In addition to retaining 3% of the disposal consideration, the acquirer must also furnish a return under the RPGT;
- Disposal of an industrial building is subject to RPGT on the gains;
- Disposal of an industrial building is also subject to balancing adjustments related to the IBA claimed under the Income Tax Act; and
- There is a difference between a premium, which is a capital amount for the right to lease the land for a specified period, and the land rent, which is revenue in nature, for the use of the land.

Strategic Professional – Options

Advanced Taxation – Malaysia (ATX – MYS)

September/December 2018 – Sample Questions

ATX MYS ACCA

Time allowed: 3 hours 15 minutes

This question paper is divided into two sections:

Section A – BOTH questions are compulsory and MUST be attempted

Section B – BOTH questions are compulsory and MUST be attempted

Tax rates and allowances are on pages 2–4

Do NOT open this question paper until instructed by the supervisor.

This question paper must not be removed from the examination hall.

ATX – MYS

Think Ahead ACCA

The Association of Chartered Certified Accountants

SUPPLEMENTARY INSTRUCTIONS

1. You should assume that the tax rates and allowances shown below will continue to apply for the foreseeable future.
2. Calculations and workings should be made to the nearest RM.
3. All apportionments should be made to the nearest whole month.
4. All workings should be shown.

TAX RATES AND ALLOWANCES

The following tax rates, allowances and values are to be used in answering the questions.

Income tax rates

Resident individual

Chargeable income	RM	RM	Rate %	Cumulative tax RM
First	5,000	(0 – 5,000)	0	0
Next	15,000	(5,001 – 20,000)	1	150
Next	15,000	(20,001 – 35,000)	3	600
Next	15,000	(35,001 – 50,000)	8	1,800
Next	20,000	(50,001 – 70,000)	14	4,600
Next	30,000	(70,001 – 100,000)	21	10,900
Next	150,000	(100,001 – 250,000)	24	46,900
Next	150,000	(250,001 – 400,000)	24·5	83,650
Next	200,000	(400,001 – 600,000)	25	133,650
Next	400,000	(600,001 – 1,000,000)	26	237,650
Exceeding	1,000,000		28	

Resident company

Paid up ordinary share capital	First RM500,000	Excess over RM500,000
RM2,500,000 or less	18%	24%
More than RM2,500,000	24%	24%

Non-residents	
Company	24%
Individual	28%

Labuan entity – income from a Labuan trading activity	
All chargeable profits	3%

Trust body – resident or non-resident	
All chargeable income	24%

Personal reliefs

		RM
Self		9,000
Disabled self, additional		6,000
Medical expenses expended on parents	(maximum)	5,000
Medical expenses expended on self, spouse or child with serious disease, including up to RM500 for medical examination	(maximum)	6,000
Parental care	(each)	1,500
Basic supporting equipment for disabled self, spouse, child or parent	(maximum)	6,000
Study course fees for skills or qualifications	(maximum)	7,000
Lifestyle allowance		2,500
Spouse relief		4,000
Disabled spouse, additional		3,500
Child – basic rate	(each)	2,000
Child – higher rate	(each)	8,000
Disabled child	(each)	6,000
Disabled child, additional	(each)	8,000
Childcare (below six years old)	(maximum)	1,000
Breastfeeding equipment	(maximum)	1,000
Life insurance premiums and contributions to approved funds	(maximum)	6,000
Private retirement scheme contributions, deferred annuity premiums	(maximum)	3,000
Medical and/or education insurance premiums for self, spouse or child	(maximum)	3,000
Deposit for a child into the National Education Savings Scheme	(maximum)	6,000
Contribution to Social Security Organisation (SOCSO)	(maximum)	250

Rebates

Chargeable income not exceeding RM35,000	**RM**
Individual – basic rate	400
Individual entitled to a deduction in respect of a spouse or a former wife	800

Capital allowances

	Initial allowance (IA) Rate %	**Annual allowance (AA) Rate %**
Industrial buildings	10	3
Plant and machinery – general	20	14
Motor vehicles and heavy machinery	20	20
Office equipment, furniture and fittings	20	10
Agriculture allowance		
Buildings for the welfare of or as living accommodation for farm employees	Nil	20
Other buildings used in the business	Nil	10
All other qualifying agricultural expenditure	Nil	50

Real property gains tax (RPGT)

Category of disposal	Companies Rate %	Individuals – non-citizens and non-permanent residents Rate %	All other persons Rate %
Disposal within three years after the date of acquisition	30	30	30
Disposal in the fourth year after the date of acquisition	20	30	20
Disposal in the fifth year after the date of acquisition	15	30	15
Disposal in the sixth year after the date of acquisition or thereafter	5	5	0

Goods and services tax (GST)

Standard rate	6%

Stamp duty

Rates of duty under the First Schedule

Conveyance, assignment, transfer or absolute bill of sale

	Rate %
Sale of property	
For every RM100 or fractional part thereof:	
On the first RM100,000	1
On the next RM400,000	2
On the excess over RM500,000	3
Sale of company shares	
On every RM1,000 or fractional part thereof	0·3

Section A – BOTH questions are compulsory and MUST be attempted

1 You are a tax assistant in Tax Firm which has the ABC group as one of its clients.

The holding company, ABC Sdn Bhd (ABC), operates an established oil palm plantation, milling the fresh fruit bunches into crude palm oil. ABC sells its entire crude palm oil output to its wholly-owned subsidiary, DEF Sdn Bhd (DEF), to be refined into speciality oils for the Malaysian food industry. Both ABC and DEF are very profitable companies, close their accounts annually to 30 September, and have no unabsorbed losses or unabsorbed capital allowances brought forward.

A few days ago, your tax partner met with the group managing director of the ABC group and learned that the group is planning to carry out research and development (R&D) to enable them to process and recycle the waste products from the mill into high grade poultry feed. The production of poultry feed in Malaysia is encouraged by the Malaysian Investment Development Authority (MIDA), and it is therefore listed as a promoted product.

If this proves to be successful, the ABC group sees scope for further R&D activities for both ABC and DEF arising from other plantation by-products (such as fronds and timber) and speciality oils.

The ABC group intends to spend RM20 million in total on the first project in year one as follows:

		RM'000
R&D business	– purchase of research equipment and facility	3,000
	– manpower and fees to carry out the R&D	4,000
Poultry feed business	– New factory premises and plant and machinery for production of the poultry feed	13,000

ABC is seeking advice from Tax Firm regarding how best to carry out the project within the ABC group, and also the impact of this choice on a future disposal of the R&D and/or poultry feed business.

This morning, you received an email from your tax partner regarding the ABC group.

Extract from your tax partner's email

Please draft a report to the chairman of the ABC board of directors addressing the following issues:

(a) R&D activity

Explain the relevant tax incentives available if the R&D is carried out:

– by ABC itself; or

– by a new Company X incorporated solely to carry out R&D work to cater for the research needs of ABC initially, and subsequently DEF as well. Company X would be a 100% subsidiary of ABC.

For this part (a), assume that Company X will:

– charge an R&D fee of RM4 million to ABC; and
– will be profitable after 12 months of operation.

(b) Production of poultry feed

Explain the relevant tax incentives available if the production of poultry feed is undertaken:

– by DEF as a diversification project under the Income Tax Act; or

– by another new Company Y incorporated as a 100% subsidiary of ABC, which intends to apply for incentives under the Income Tax Act or the Promotion of Investments Act.

– For this part (b), assume the poultry feed business will take 36 months of operation to become profitable.

(c) Tax savings

Illustrate the tax impact of the R&D activity and the poultry feed production by computing the potential tax savings for the ABC group in year one of the project under each of the alternative strategies in parts (a) and (b).

You should assume that all companies in the ABC group pay tax at a rate of 24%.

Extract from your tax partner's email (continued)

> **(d)** Recommendations
>
> Recommend, based on the relative tax treatment and tax savings identified in parts (a), (b) and (c), which company should undertake the R&D work and which company should undertake the production of poultry feed.
>
> **(e)** Future disposal of R&D business and/or poultry feed business
>
> Advise whether your recommendations would change if ABC were planning to dispose of the R&D business and/or the poultry feed business in the fifth year of operation.

Required:

Prepare the draft report to the chairman of the ABC Sdn Bhd board of directors as instructed by your tax partner.

The following marks are available:

(a) The tax incentives for the R&D activity; (7 marks)

(b) The tax incentives for the production of the new product of poultry feed; (6 marks)

(c) Computation of potential tax savings for parts (a) and (b); (8 marks)

(d) Recommendations of which ABC group company should undertake the R&D activity and which should undertake the poultry feed business; (6 marks)

(e) Changes to your recommendations if an exit is planned for the fifth year of operation. (4 marks)

Professional marks will be awarded in question 1 for adopting a logical approach, the appropriateness of the format and presentation of the report, and the effectiveness with which the information is communicated. (4 marks)

(35 marks)

2 The tax manager of Tax Firm received a telephone call on 2 December 2018 from Ms Dei, who is seeking confirmation of the correct tax treatment for several property disposals and also income generated from the provision of design services.

Your tax manager made the following notes during the call:

Notes from telephone call with Miss Dei on 2 December 2018

Ms Dei, a Malaysian citizen and resident, is an architect employed by a firm in Kuala Lumpur. Since 1 January 2016, she has been working three days a week for the firm, devoting the remaining days of each week to her other interests.

Property disposals

Ms Dei purchased her first residential property, a terraced house in Petaling Jaya, in 2009. She redesigned it, furnished it, and lived in it before selling the property in 2016 for twice the price she purchased it for. A real property gains tax (RPGT) return was duly submitted.

In January 2017, Ms Dei reinvested the proceeds from the disposal of the terraced house by purchasing a condominium unit in Kuala Lumpur. Ms Dei has similarly redesigned, furnished the property and has been residing in it. After putting the condominium on the market, Ms Dei has accepted an offer for the property which is RM400,000 more than she paid for it.

In 2010, Ms Dei inherited five acres of agricultural land in Pahang. She has since fenced up the area, built roads, planted 'musang king' durian trees, and enjoyed 'back-to-nature' weekends at the '*Durian Haven*'. A Chinese businessman, who heard about *Durian Haven* through a mutual friend, has recently made a generous offer to buy it. Ms Dei is considering whether to accept this offer.

Ms Dei is unsure how these three property gains should be treated for tax purposes.

Design services

When not working for her employer, Ms Dei designs private residential houses for friends and acquaintances, all from within Malaysia. She maintains a duly-equipped studio-office at her home in Kuala Lumpur for this purpose. She considers the activity to be a hobby which she does by herself, and therefore does not report the amounts received for these designs in her annual tax return. She received gross fees of RM70,000 in YA 2017 and expects that the gross fees in YA 2018 will be RM150,000.

In September 2018, in response to a request for her design services, she made a visit to Singapore to assess the site, receive instructions and agree to the terms of the assignment. She worked on the designs from her studio-office at home in Malaysia. In November 2018, she visited Singapore again to present and hand over the architectural plans, after which she was paid the agreed fee of RM50,000.

Note from your tax manager

I have arranged a meeting with Ms Dei next week, and in preparation for that meeting, I would like you to carry out the following work:

(a) Treatment of property gains

Based on the information provided by Ms Dei on her property acquisitions and disposals:

(i) Present arguments for and against the treatment of the RM400,000 gain on the disposal of the Kuala Lumpur condominium as income from an adventure in the nature of trade. State your conclusion regarding the correct treatment.

(ii) Explain both the capital and revenue arguments in respect of the potential gain from the proposed disposal of *Durian Haven*. State your conclusion regarding the correct treatment.

(iii) In light of the disposals in parts (a)(i) and (a)(ii), reassess the treatment of the gain on the disposal of the terraced house in Petaling Jaya in the year of assessment 2016.

(b) Design service income

(i) Explain how you would support classifying the RM70,000 received by Ms Dei for design services in the year of assessment 2017 as business income.

(ii) Explain why the RM50,000 fee Miss Dei receives for the Singapore work should be treated as part of her business income derived from Malaysia for the year of assessment 2018.

State the expenses incurred by Miss Dei which would likely qualify as tax deductions in arriving at the adjusted income from the business.

(c) With reference to the non-disclosure of her design service income, state the potential offence, if any, committed by Ms Dei for the years of assessment 2017 and 2018, and any action Ms Dei should take to rectify the situation.

Required:

Prepare notes for your manager addressing the work he has asked you to perform.

The following marks are available:

(a) (i)	**Treatment of the gain on disposal of the Kuala Lumpur condominium.**	(6 marks)
(ii)	**Treatment of the potential gain on the planned disposal of *Durian Haven*.**	(4 marks)
(iii)	**Treatment of the gain on disposal of the terraced house.**	(2 marks)
(b) (i)	**YA 2017 design service income.**	(3 marks)
(ii)	**YA 2018 Singapore design service income.**	(6 marks)
(c)	**Non-disclosure of income for YA 2017 and YA 2018.**	(4 marks)
		(25 marks)

Section B – BOTH questions are compulsory and MUST be attempted

3 Welcome Hospitality College Sdn Bhd (WHC), based in Penang, specialises in providing hospitality training courses. WHC has a wholly-owned subsidiary, Tanah Sdn Bhd (Tanah), which provides residential accommodation to the students. WHC is registered for goods and services tax (GST) whilst Tanah is NOT a GST registrant.

WHC provides a cafeteria for students to use on its existing campus. Due to the danger arising from several leakages in the gas pipe system in the cafeteria's kitchen, WHC needed to carry out repair work promptly. The contractor whom WHC engaged to do the work informed the company that it would be faster and cheaper to encase the entire gas pipe system in new larger pipes rather than to repair the individual leakages in the system.

As part of WHC's expansion plan, a new campus is being built on land owned by Tanah. Upon completion of the campus property, it will be let out to WHC.

The managing director of WHC has been informed by a friend that the proposed arrangement whereby Tanah will own and let out the new campus property to WHC is not tax efficient. The friend has suggested that WHC should immediately acquire the campus property, and when it is ready, the property will be used for its own college operations, rather than being leased from Tanah. The value of the new campus property is RM20 million.

WHC is unsure how this suggested course of action could improve its tax position, and is concerned that if that were the case, whether this could be viewed as a tax avoidance scheme by the Inland Revenue Board (IRB).

Required:

(a) Justify how the gas pipe system qualifies as 'plant'. Identify whether the encasement of the pipes is capital or revenue in nature and the corresponding appropriate tax treatment. (5 marks)

(b) Explain how Welcome Hospitality College Sdn Bhd (WHC) purchasing the new campus property from Tanah Sdn Bhd (Tanah) could improve the tax position of the group, and whether the proposal could be regarded as a tax avoidance scheme by the Inland Revenue Board (IRB). (9 marks)

(c) Advise the management of WHC of the goods and services tax (GST) implications of the proposed transfer of the new campus property from Tanah to WHC. You should consider whether any reliefs may be applicable. (6 marks)

(20 marks)

4 **(a)** Mas and her daughter, Linda, are the only shareholders of Selamat Datang Sdn Bhd (SD). The company is engaged in the business of property letting and management in Malaysia.

To expand SD's property portfolio, Mas is proposing to transfer an office block which she owns personally to the company for consideration of RM10 million. Mas acquired the office block eight years ago for RM6 million. The transfer consideration will be wholly satisfied in the form of shares in SD.

Required:

(i) Advise Mas of the real property gains tax (RPGT) implications of the proposed transfer of the office block from Mas to Selamat Datang Sdn Bhd (SD), and a subsequent disposal of the office block by SD. You should consider the applicability of any reliefs and the conditions which apply. (7 marks)

(ii) Suggest how the proposed transfer of the office block from Mas to SD could be altered to achieve a greater tax efficiency on a future disposal of the property by SD. (3 marks)

(b) World Best Berhad (WBB), a listed company on Bursa Malaysia, decided to use its available cash to repurchase its own shares from Bursa Malaysia as the prevailing market price of the shares is below its net asset value. By reducing the number of shares in the market, WBB hopes to improve the market price of the shares. Depending on the market conditions, the repurchased shares may be subsequently resold or cancelled.

Required:

Explain the income tax treatment of the repurchase of World Best Berhad's shares and its subsequent resale or cancellation. (4 marks)

(c) Siew Mai Sdn Bhd (SM) is a trading company which manufactures materials used in the building trade. SM normally prepares its accounts annually to 31 March. The company submitted an original tax estimate of RM120,000 for the year of assessment 2019. On 2 September 2018, before paying the fifth instalment, SM submitted a revised tax estimate of RM180,000.

Earthquakes in other parts of the world have resulted in markedly increased orders for SM's products since September 2018. This will lead to a further higher tax estimate of RM350,000.

Required:

(i) Compute the monthly revised tax instalments for the year of assessment 2019 following the submission of the revised tax estimate in September 2018. (2 marks)

(ii) State the course of action which Siew Mai Sdn Bhd (SM) may take in respect of its revised tax estimate of RM350,000 in view of the unexpected increase in profits. (2 marks)

(iii) If no action is taken under (ii) above, and assuming the final tax liability of SM is RM400,000 for the year of assessment 2019, compute the amount of penalty which will be levied, if any. (2 marks)

(20 marks)

End of Question Paper

1 Report to ABC Sdn Bhd

From Tax Firm
To Chairman, Board of directors, ABC Sdn Bhd
Date 4 December 2018

This report considers the key tax issues of the ABC Group's plan to venture into research and development (R&D) leading onto the production of poultry feed.

(a) Proposed R&D activity

After due consideration, Tax Firm is of the view that the R&D activity may be viably undertaken (1) by ABC Sdn Bhd (ABC), or (2) by a newly-incorporated 100% subsidiary: Company X.

(1) Under ABC
If ABC undertakes the R&D activity, it may apply to the Minister of Finance (MoF) for approved R&D status under the Income Tax Act [s.34A] to qualify for a double deduction of the expenses directly related to research. The capital expenditure on equipment will qualify for capital allowances at the normal rates.

In addition, ABC may also apply for the tax incentive of in-house R&D under the Promotion of Investments Act (PIA)[s.27E]. If successful, ABC will be eligible for an investment tax allowance (ITA) of 50% of the qualifying capital expenditure, to be set off against 70% of statutory income of the year of assessment (YA). Any unabsorbed allowance may be carried forward until fully utilised.

(2) Under new Company X
The new Company X will carry out the R&D activities in Malaysia on behalf of its holding company, ABC. It therefore fulfils the definition [in s.2 of PIA] of a research and development (R&D) company. As Company X will carry out R&D activities in Malaysia and render R&D services to ABC, a related company, it may apply to the MoF for approval [under s.27D of PIA] as an R&D company.

If approved, it will be eligible for ITA at the rate of 100% of qualifying capital expenditure to be set off against 70% of the statutory income of that YA. Any unabsorbed amount may be carried forward until fully utilised.

ABC, being a related company paying fees for R&D to Company X, will not qualify for the double deduction [under s.34B] for R&D fees. However, ABC is eligible for a single deduction [under s.34(7)] for 'scientific research related to its business and directly undertaken by him or on his behalf' as the research is scientific in nature and is related to the by-product of its milling activity.

Alternatively, Company X may opt to apply for the status of R&D company without applying for the ITA. This will enable ABC to claim a double deduction in respect of the R&D fees it pays to Company X.

(b) Production of the poultry feed

There are two alternatives for the production of the poultry feed: it may be undertaken by (1) DEF, or (2) by a new Company Y, as explained below.

(1) By DEF
DEF's current trade is the manufacturing of speciality oils for the food industry. If it takes on the production of poultry feed, it will likely be able to justify that it is diversifying within the food industry. This will therefore constitute a qualifying project for reinvestment allowance (RA) and DEF will be able to claim, in addition to the capital allowances, another 60% of the qualifying capital expenditure. The RA is available for set off up to a maximum of 70% of the statutory income from the poultry feed business for a YA. Any unabsorbed RA may be carried forward until fully utilised.

[**Tutorial note:** *The tax partner's specific instruction is to consider tax incentives available under the Income Tax Act, and therefore only RA is available/relevant. Investment tax allowance is an incentive available under the Promotion of Investments Act.*]

(2) By new Company Y
A new Company Y will not be eligible for reinvestment allowance but it will be able to apply for investment tax allowance (ITA) or pioneer status (PS), given that poultry feed is a promoted product.

As Company Y will take at least three years before it becomes profitable, PS is not a beneficial incentive: there will not be any profit to enjoy the tax exemption for the first three years, and therefore only two years will effectively enjoy tax relief.

Under ITA, 60% of the qualifying capital expenditure of RM13 million is eligible for set off against up to a maximum of 70% of the statutory income for a YA from the poultry feed business. Any unabsorbed ITA may be carried forward from the initial years to be set off against the statutory income from the fourth year onwards until fully utilised. ITA is therefore a better incentive measure to go for.

(c) Computation of tax savings to the ABC Group

We have computed the potential tax savings and tax balances for each of the scenarios in the Appendix attached herewith.

(d) Our recommendations

R&D

Having ABC carry out the R&D activity as an approved R&D [s.34A, Income Tax Act] AND an in-house R&D [s.27E, PIA] yields a tax saving of RM3 million. This compares very favourably to the scenario where new Company X carries out the R&D, as the latter manages to produce tax savings of only RM2·64 million. The tax difference of RM360,000 is substantial and merits consideration. Moreover, as the existing plantation business is very profitable and therefore paying taxes, the tax savings from the RM3 million deduction will arise within the first year itself.

We recommend that ABC undertakes the R&D activity.

Production of poultry feed

Interestingly, both options produce the same amount of tax savings. Accordingly, to give a recommendation, other factors should be considered.

Although claiming RA is not subject to a prior approval process, DEF's claiming RA does potentially mean that the Inland Revenue Board (IRB) may dispute the claim on interpretation of terms such as 'diversification', factory space and plant and equipment directly used in the production process, etc.

By contrast, ITA requires prior approval from the Malaysian Investment Development Authority (MIDA). Once the approval is obtained, the claiming process is fairly straight forward and not fraught with interpretational issues.

The ABC Group should not encounter difficulties in securing the requisite approval from MIDA. We therefore recommend that the Group incorporates a new company to undertake the production of poultry feed, and apply for ITA.

(e) Our recommendation if an exit is planned for the fifth year

R&D activity

If the ABC Group is planning to dispose of the R&D outfit and the poultry feed production facility in the fifth year of operation, our recommendation will have to take into consideration the exit strategy.

With regard to the R&D activity, if ABC were to take it on, any subsequent disposal will have to be an asset sale rather than a share sale. This means that the R&D business assets and liabilities will have to be identified and kept separate and distinct from those of the plantation business, which may prove difficult in practice.

If Company X were to take on the R&D activity, a subsequent sale will simply mean a disposal of the shares of the company.

On balance, it is conceivably much simpler and less problematic to sell the shares of a company rather than sell one of the component businesses of an entity. Our recommendation will therefore be revised: that a new Company X should be incorporated to undertake the R&D activity if an exit is envisaged within five years.

[**Alternative argument**

The recommendation for R&D remains unchanged as ABC may just dispose of the R&D assets which are clearly identifiable from the oil palm plantation and mill business. In addition, the R&D undertaken by ABC is more tax efficient and RM360,000 tax savings is undeniably a substantial amount.]

Poultry feed

As for the production of poultry feed, a disposal of assets for which RA or ITA has been claimed will be subject to a 'claw-back', i.e. a total withdrawal of the allowances, if the disposal occurs within five years for RA [paragraph 2A(1), Schedule 7A], and within two years for ITA [s.30A, PIA].

Therefore, our recommendation will still be for a newly-incorporated Company Y to be the vehicle for the poultry feed production facility because a disposal within five years but after two years will not trigger the 'claw-back'. Additionally, the sale of the shares of a company obviously involves a much simpler process when compared to the sale of a component business.

End of report

Appendix

Computation of tax savings and tax balances

	RM'000	Tax savings RM'000
R&D carried out by ABC		
R&D expenses RM4 million x 2	8,000	
In-house R&D ITA – RM3 million at 50%	1,500	
CA claim on R&D equipment at 100%	3,000	
Deductions	12,500	
Tax savings to the ABC/Group at 24%		3,000

	RM'000	Tax savings RM'000
R&D carried out by Company X		
ITA – RM3 million x 100%	3,000	
CA claim on R&D equipment at 100%	3,000	
R&D claim by ABC as payer of fees, single deduction	4,000	
Deductions to the ABC Group	10,000	
Tax savings to the Group at 24%		2,400
Alternative		
ITA	Nil	
CA claim on R&D equipment at 100%	3,000	
R&D claim by ABC as payer of fees, double deduction	8,000	
Deductions to the ABC Group	11,000	
Tax savings to the Group at 24%		2,640

Note:
The higher benefit of the two is produced by the alternative under which Company X does not claim ITA to facilitate ABC's claiming double deduction.

Production of poultry feed by DEF		
RA – RM13 million x 60%	7,800	
CA claim by DEF at 100% of RM13 million	13,000	
Total deductions claimed by the ABC Group	20,800	
Tax savings to the Group at 24%		4,992
Production of poultry feed by Company Y		
ITA – RM13 million x 60%	7,800	
CA claim by Y at 100% of RM13 million	13,000	
Total deductions claimed by the ABC Group	20,800	
Tax savings to the Group at 24%		4,992

2 Ms Dei

(a) Treatment of property disposals

(i) Kuala Lumpur condominium

Arguments for treating the gain as income

– Efforts to improve and enhance the asset were made, making it more saleable.
– She had a related interest: as an architect, she is trained in the field of property design, so she was acting in a professional mode. Her knowledge of the property market and her experience afford her an advantage.
– Though her professed intention was for personal occupation, her action, i.e. putting it on the market after barely two years, indicated otherwise.
– This was a repeat of an earlier endeavour which yielded a profit: there is a pattern which indicates profit-seeking motive.
– The property was put on the market: a buyer was sought out, it was not fortuitous.

Arguments for treating the gain as capital

– Ms Dei lived in the condominium: it was her home, therefore her capital asset.
– The property was financed partly from the gain of a previous home, so financially, this is not a position where there must have been an intended fast resale to repay financing.
– As the earlier transaction was a capital transaction, this transaction should not be regarded as part of a pattern of profit-seeking motive.
– No frequency, hence no repetition, is established.
– Putting the property on the market does not, by itself, conclusively prove the profit-seeking motive.

Conclusion
This was not an adventure in the nature of trade, as the profit-seeking motive was not strongly substantiated, and there was not enough frequency to establish a pattern.

Alternative conclusion
It was an adventure in the nature of trade because of her previous record of dealing in property, her knowledge in the related field, the work done to improve the saleability of the property, the short holding period and the effort made to sell.

(ii) Disposal of *Durian Haven*

Argument for capital gain
- As the five-acre agricultural land was inherited, not purchased, it would be difficult to argue that it was acquired with the intention to turn over for profit.
- The fencing, the roads and the planting of prized durian trees were done to make it safe and enjoyable for weekend visits to the farm: all for personal enjoyment.
- Ms Dei did not actively seek out a buyer: the buyer made an unsolicited offer.
- The holding period of eight years is by no means short: the long holding period arguably supports the contention that the property was held as an investment.
- Overall: no profit-seeking motive.

Argument for revenue gain
- Installing fencing, building roads and planting fruit trees are deliberate actions to improve and enhance the value of the land. Work done to make the asset more marketable supports the contention that a trade intention exists.
- This is the second time Ms Dei is dealing in real properties: frequency.

Conclusion
The gain of disposal is capital in nature as the profit-seeking motive is not substantiated.

(iii) Petaling Jaya (PJ) terraced house

What Ms Dei did with the PJ house is no different from any other house owner. The property was a capital asset of Ms Dei, and upon its disposal, the gain therefrom would clearly be capital in nature. Under real property gains tax, a citizen is entitled to zero rating after holding the asset for more than five complete years.

The fact that Ms Dei subsequently engaged in more property transactions should not retrospectively affect or change the nature of this transaction in 2016.

(b) Design service income

(i) Business income for 2017

'Business' is defined to include profession, vocation and trade and every manufacture, adventure or concern in the nature of trade, but excludes employment.

Ms Dei is, by profession and training, an architect. The services she renders to her friends and friends' friends are professional services, which are no different from what she does in her employment capacity, except that she does them on her own behalf and she is directly remunerated for the services. Although she does them in her spare time, she nevertheless carries out the activity in an organised manner, having a studio-office in her home. In this case, it is not a hobby to her. Even if it is a hobby, it does not preclude it from being a business.

(ii) Business income for 2018

RM50,000 from the Singapore client is part of the business income derived from Malaysia. The business is carried out from her studio-office in Kuala Lumpur. The Singapore assignment is essentially carried out from Malaysia as the core design work was done in Malaysia. The visits to Singapore to assess the site, discuss the terms and determine the instructions were preparatory in nature. The design work was the activity which yielded the income and this activity took place in Malaysia. Hence the RM50,000 from the Singapore assignment was derived in Malaysia and is duly subject to tax in Malaysia.

The tax deductions in arriving at the adjusted income from the business are likely to include:

- the cost of maintaining the studio-office,
- the rental, repair and maintenance expense of any office equipment, computer system, etc used in the business,
- the stationery and office supplies, and
- the travelling expenses to clients' premises, including to Singapore.

(c) Potential offence and action needed

YA 2017
By not reporting the business income for YA 2017, Ms Dei has submitted an incorrect tax return and understated income. This is an offence under the law [s.113(2)].

Ms Dei can rectify the situation by filing an amended return for YA 2017 to include the income from the design fees. Reasonable deductions which fulfil the deductibility tests and capital allowance for assets used in the business may be claimed against the gross fees of RM70,000.

This amended return must be completed/submitted within six months of the due date of furnishing the return for YA 2017, which is six months after 30 June 2018, i.e. 31 December 2018. In this amended return, Ms Dei must include the late payment penalties of 10% + 5% in relation to any under-declared tax.

YA 2018
As the tax return for YA 2018 is only due to be furnished by 30 June 2019, no offence has been committed yet.

In addition to her employment income, Ms Dei must ensure that the RM150,000 is included as her business income, from which may be deducted expenses and capital allowances.

3 Welcome Hospitality College Sdn Bhd (WHC)

(a) Replacement of the gas pipe system

The gas pipe system performs the active function of conveying gas to the kitchen equipment. In line with case law definition, it qualifies as 'plant'.

A repair and renewal involves the replacement of a subsidiary part of the whole asset (the entirety). Generally, repair and renewal, which do not materially add to the value nor appreciably prolong the life of an asset, but merely keep it in good and efficient operating condition, are deductible. If the replacement of the asset is of its entirety, then it will not be deductible, as it does not constitute repair and renewal. Only the replacement of a part of the assets will rank for deduction.

The company is replacing the entire gas pipe system. As the entire gas pipe system is being replaced, the cost does not constitute repair and renewal and, therefore, is capital in nature and is not eligible for outright deduction.

Instead, the replacement cost qualifies as plant expenditure, eligible for capital allowances as the asset is used in the company's business.

(b) Proposal to transfer the new campus property to WHC

The construction or purchase of a building by a person for an educational institution approved by the Minister of Higher Education can be treated as an industrial building. However, no allowance will be given where the building or part thereof is used by a person for the purpose of letting of property including the business of letting of property. In other words, in order for the educational building to be eligible for industrial building allowance (IBA), the owner must operate the college operations as well. Therefore, where Tanah Sdn Bhd (Tanah) constructs the campus building and thereafter lets it out to WHC, Tanah is not eligible to claim IBA.

If Tanah transfers the campus property to WHC, the latter, as the owner-operator, will be eligible to claim IBA. The IBA can then be used to shelter against the college business income of WHC.

Tax avoidance

The general anti-avoidance provision provides that where the Director General of Inland Revenue has reasons to believe that any transaction has the direct or indirect effect of altering the incidence of tax which is payable or which would otherwise have been payable by any person, he may disregard or vary the transaction and make such adjustments as he thinks fit for tax purposes with a view to counter-acting the whole or any part of any such direct or indirect effect of the transaction [s.140, the Income Tax Act].

[**Tutorial note:** *The above is without prejudice to such validity as the transaction may have in any other respect or for any other purpose, other than tax.*]

However, based on established case law, if a transaction is capable of justification by reference to ordinary business dealings without necessarily being labelled as a means to avoid tax, then the arrangement should not be caught by the anti-avoidance provision. It is, therefore, of great importance that the taxpayer is able to demonstrate that any transaction entered into is driven by commercial expediency, and that any tax benefit derived is purely incidental, in order for it to counter any challenge of tax avoidance by the tax authorities.

In the present case, Tanah is currently holding the land and in the midst of constructing the new campus. The question then is whether the transfer of the new campus property to WHC can be supported with commercial rationale. As WHC is the college operator, it makes sense for WHC to acquire the property instead of leasing it from Tanah. In addition, as Tanah is only involved in the business of residential accommodation for students, it had never let out any campus property and, therefore, the transfer of the new campus property to WHC would allow it to rationalise its property holdings.

Therefore, WHC should be able to argue that the proposed transfer of the new campus property has commercial justification and it should reasonably be able to argue against an invocation of the anti-avoidance provisions.

(c) GST implications on transfer of property

The transfer of the new campus property, being a commercial property, is a taxable supply. As the value of the supply is more than RM500,000, this would result in Tanah breaching the GST registration threshold. As such, Tanah will be required to register for GST and, thereafter, charge GST on the transfer of the campus property.

To WHC, the new campus property would be used to provide education services. As education services is an exempt supply, it would not be eligible to claim input tax on the transfer of the campus property. The GST charge by Tanah therefore will become an additional cost to WHC.

Notwithstanding that WHC and Tanah are within the same group, they are not eligible for the grouping provision: grouping provision is applicable only where both the transferor and transferee are wholly taxable suppliers. As WHC is a mixed supplier (by providing exempt education services), the grouping provision is not applicable.

In addition, relief under the transfer of a business on a going concern (TOGC) is unlikely to apply as there is no transfer of business. Tanah is merely transferring the campus property under construction which does not constitute a business for GST purposes.

4 (a) (i) Mas

Transfer of the office block
The transfer of the office block from Mas to Selamat Datang Sdn Bhd (SD) is a disposal of chargeable asset, and would attract real property gains tax (RPGT).

There is, however, relief as provided under law [paragraph 3(b), Schedule 2] which states that the disposal price shall be deemed to be equal to the acquisition price, i.e. no-gain-no-loss (NGNL), if:

– the transaction involves the transfer of an asset
– owned by an individual, by his wife or by an individual jointly with his wife or with a connected person
– to a company (whether or not resident in Malaysia) controlled by the individual, by his wife or by the individual jointly with his wife or with a connected person
– for a consideration consisting of shares in the company or for consideration consisting substantially of shares in the company and the balance of a money payment.

As SD is a company controlled by Mas and her daughter, Linda, and the consideration for the transfer is entirely in the form of shares in SD, the transfer may be regarded as a NGNL transaction.

Therefore, Mas will not face an immediate exposure to RPGT arising from the transfer. The shares in SD thus acquired by Mas represent a chargeable asset to her.

Acquisition price and date of the office block to SD
As a NGNL transaction, SD will inherit the original acquisition price of the office block of RM6 million even though SD has paid RM10 million for the property. The date of acquisition of the property, however, would be based on the date of transfer of the property.

(ii) Suggestion to maximise tax efficiency

The application of NGNL to the transaction merely represents a deferment of the RPGT exposure. In the present case, as Mas has held the property for more than five years and the applicable RPGT rate is nil, the application of the NGNL provision is not beneficial. In order to fall outside the scope of the NGNL provision, consideration may be given to transfer the property to SD in consideration for cash. In such a case, the conditions for the no-gain-no-loss provision cannot be met and normal RPGT provisions would then apply. This would mean that Mas would have a chargeable gain of RM4 million (RM10 million less RM6 million) but as the RPGT rate is nil, there is no RPGT exposure. To SD, the acquisition price of the property for RPGT purposes is RM10 million, thereby minimising RPGT exposure on the subsequent disposal of the property.

(b) Purchase of own shares

The repurchase of a company's own shares relates to the equity structure of the company; it is therefore regarded as capital in nature. It follows that the cost of purchasing its own shares would not be eligible for a tax deduction.

As dealing in its own shares is not the ordinary course of business activities of the company, such a transaction would be regarded as capital in nature; any gains will not be taxable while any loss will not be deductible.

The subsequent cancellation of the shares will similarly not have any income tax implications.

(c) Siew Mai Sdn Bhd (SM)

(i) Revised monthly instalment

	RM
Revised tax estimate	180,000
Tax instalment paid (RM120,000/12 months x 4 months)	(40,000)
	140,000
Revised instalment payment (RM140,000/8 months)	17,500

(ii) Increased profits – course of action available

As SM is now in its ninth month of the basis period (April – December 2018), there is time until the end of December 2018 to submit an increased tax estimate of up to RM350,000.

(iii) Excessive difference – computation of penalty

The law [s.107C(10)] stipulates that where the final tax liability exceeds the revised tax estimate by more than 30%, the amount in excess of the 30% will be subject to a 10% penalty.

In this case, if no action is taken under (ii) above, and assuming the final tax liability of SM is RM400,000, the penalty for under-estimation of tax for the year of assessment 2019 is calculated as follows:

	RM
Final tax liability	400,000
Less Revised tax estimate	(180,000)
Balance of tax payable	220,000
Less 30% of final tax liability	(120,000)
Excessive difference	100,000
Penalty at 10%	10,000

			Marks
1	**(a)**	**R&D activity**	
		Under ABC	
		Incentive: approved research – double deduction, normal CA	1 + 1 + 0·5
		Incentive: in-house R&D – 50% ITA, 70% of SI, c/f	1 + 0·5 + 0·5
		Under Company X	
		Incentive: R&D company, eligibility, 100% ITA, 70% SI, c/f	1 + 0·5 + 0·5
		ABC's single deduction	1
		Alternative: X to forgo ITA, ABC to claim double deduction	0·5 + 0·5
		Available	8·5
		Maximum	7
	(b)	**Production of poultry feed**	
		By DEF	
		RA: why eligible: diversification, basis, qualifying project	1 + 1 + 0·5
		RA claim: 60% of QCE against 70% SI	0·5 + 0·5
		By Company Y	
		ITA or pioneer: pioneer ruled out	1 + 0·5
		ITA: 60%, c/f, against 70% SI	0·5 + 0·5
			6
	(c)	**Computation of tax savings**	
		R&D carried out by ABC	2
		R&D carried by Company X – 1·5 x 2 alternatives	3
		Production of poultry feed by DEF	1·5
		Production of poultry feed by Company Y	1·5
			8
	(d)	**The recommendations**	
		R&D – basis	1 + 2
		Production of poultry feed – basis	1 + 2
			6
	(e)	**Recommendations with exit in mind**	
		R&D – change, basis	1 + 1
		Production of poultry feed – same, basis	1 + 1
			4
	Professional marks		
	Format and presentation of the report		1
	Clarity and effectiveness of communication including logical flow		2
	Appropriate use of appendix		1
			4
			35

				Marks
2	**(a)**	**(i)**	**KL condominium – adventure in the nature of trade?**	
			Arguments for revenue	2·5
			Arguments for capital	2·5
			Conclusion	1
				6
		(ii)	***Durian Haven* – capital or revenue?**	
			Argument for capital	2·5
			Argument for revenue	1·5
			Conclusion	1
			Available	5
			Maximum	4
		(iii)	**Gain on sale of terraced house**	
			Capital asset, capital gain	1
			RPGT, citizen, more than five years, zero rating	1
			Subsequent development should not change nature	1
			Available	3
			Maximum	2
	(b)	**(i)**	**RM70,000 is business income**	
			'Business' defined	0·5
			Why business income	2·5
				3
		(ii)	**Singapore assignment – derived from Malaysia?**	
			Business carried on in KL, basis	1
			Why Singapore assignment income is derived from Malaysia, activity, where carried out	1 + 1 + 1
			Deductions: 0·5 x 4	2
				6
	(c)	**Potential offence and corrective measure**		
		YA 2017		
		Offence – incorrect return		1
		Corrective measure – amended return		1
		Within six months, date; penalties 10% + 5%		1
		YA 2018		
		No offence yet		0·5
		Ensure disclosure		0·5
		Return by 30 June 2019		1
			Available	5
			Maximum	4
				25

			Marks
3	(a)	Constitute 'plant', reason	1 + 1
		Deduction rules on repair/renewals	1
		Replacement of entirety v part of asset	1
		Capital in nature, qualify for CA	1 + 1
		Available	6
		Maximum	5
	(b)	Building approved by MOHE	1
		Owner/operator	0·5 + 1
		Application to Tanah/WHC scenario	2
		Anti-avoidance rule	2
		Commercial basis	1
		Analysis	2
		Available	9·5
		Maximum	9
	(c)	New campus is a taxable supply	1
		Triggered registration threshold	1
		Register and charge GST	1
		GST not recoverable to WHC	1
		Grouping provision not applicable + reason	1 + 1
		TOGC + reason	1 + 1
		Available	8
		Maximum	6
			20

					Marks
4	(a)	**RPGT – Mas**			
		(i)	Subject to RPGT, reason		1
			Relief: NGNL + reasons		1 + 1
			Why NGN applicable to Mas		1
			Consideration in the form of shares in transferee company is chargeable asset		1
			Disposal by SD		
			Acquisition price of Mas is deemed acquisition price of SD		1
			Acquisition price		1
			Acquisition date		1
				Available	8
				Maximum	7
		(ii)	NGNL merely deferment		0·5
			Better for normal provision to apply		0·5
			Change consideration to cash		1
			Resultant treatment		1
					3
	(b)	**Purchase of own shares**			
		Purchase of own shares – relate to equity structure/not tax deductible			1 + 1
		Resale of shares – not normal business dealings/not taxable			1 + 1
		Cancellation of shares			1
				Available	5
				Maximum	4
	(c)	**Siew Mai Sdn Bhd**			
		(i)	Revised tax instalments		2
		(ii)	Revise tax estimate in ninth month, by 31 December 2018, to RM350,000		2
		(iii)	Compute excessive difference and penalty		2
					20

Examiner’s report

Advanced Taxation (MYS)
September 2018

General Comments

The examination consisted of two sections. Section A contained Q1 for 35 marks and Q2 for 25 marks, with a total of 60 marks. Section B contained three questions of 20 marks each, from which candidates had to answer two questions.

Taxation is intrinsically technical in nature, therefore, comprehension and building of knowledge requires tenacity and time. It does not come through rote learning but through a thorough understanding of the subject matter. The subject lends itself to a ‘principles approach’ whereby candidates must first understand the principles and then apply them to given scenarios.

The examination unavoidably contains a certain amount of technical material but a significant part of the examination is based around the application of the fundamental tax principles such as capital versus revenue, treatment of capital allowances and absorption of losses.

Question One

This question pertained to a rationalisation exercise involving a transfer of business activities. Candidates were required to explain the tax implications (income tax, real property gains tax (RPGT), stamp duty and goods and services tax (GST)) in two alternative options, with supporting calculations. Candidates were also required to consider the tax deductibility of the attendant retrenchment costs and reorganisation expenditure.

Candidates were tested on their understanding of the tax principles relating to the transfer of business assets, transfer of shares, and on their ability to apply them to the scenario. In Part (i), candidates were asked to consider the income tax treatment of Badan's transfer of the shoe-manufacturing assets. Under option 1, Badan transferred the assets to Lucky. Both Badan and Lucky are wholly and jointly owned by three unrelated resident individuals. Many candidates did not arrive at the correct conclusion that the transfer under Option 1 was not a controlled transfer because none of the three shareholders had control. It is a fundamental principle that a controlled transfer only arises when a common shareholder exercises control, i.e. more than 50% of the share capital, over both the disposer and the acquirer.

Part (i) then required candidates to consider the RPGT and stamp duty implications of the disposal of a factory and land, and the stamp duty implications of the disposal of shares. The scenario clearly stated that the company was not a real property company (RPC). Yet many candidates spent time discussing RPC shares.

The facts gave a big hint to "Remember that these transactions relate to an internal group reorganisation exercise and consider any potential relief available" which should have prompted candidates to think of available reliefs under RPGT and for stamp duty. Many candidates did not provide answers for these two aspects.

Of those who did refer to the RPGT relief under Paragraph 17(1)(a), Schedule 2 of the RPGT Act, they often did not apply the eligibility requirements of the consideration being substantially (i.e. at least 75%) in shares, and the companies being members of the same group of companies and remaining in the same group for three years after the transfer. The same went for stamp duty: candidates often did not apply the eligibility conditions of the stamp duty relief for a transfer between associated companies.

Part (iii) relating to the income tax deductibility issue was generally answered better. Nevertheless, many candidates did miss the fact that Badan retrenched its employees in connection with its cessation of the manufacturing business. They stated that retrenchment costs were deductible because they were paid to employees, which was superficial and lacked analysis of what the payment was about. Similarly, the reorganisation expenditure was concluded to be capital in nature, overlooking the fact that part of the expenditure related to a review of the marketing plan which was revenue in nature.

Candidates are reminded that they must apply the principles which they have learned to the scenario given, and should pay close attention to what is required of them in the question, which is further explained in the instructions from the manager.

Overall, this question was not satisfactorily answered.

Question Two
This question dealt with the tax incentive of pioneer status, its eligibility, the requirement of keeping separate accounts, the special treatment of losses, and the computation of exempt income and taxable total income. It also tested the comparative tax treatment of the three methods of funding the acquisition of business assets.

While the various aspects of eligibility, losses etc. were generally satisfactorily dealt with, the computations were not as well performed.

The comparative analysis of the various funding methods was satisfactorily handled, but many candidates did not reach the crucial conclusion that in this context, hire purchase prevailed over the outright purchase because it deferred the claim of capital allowances to the post-incentive period.

Question Three
Question 3(a) examined the tax treatment of a trust body and its beneficiaries. It tested the tax treatment of an annuity, trustee remuneration, donations, distributions to beneficiaries, and the amount accumulated. For many candidates, the computation of the total income of the trust needed improvement.

Part (b) dealt with a company undergoing liquidation and tested the tax treatment of pre and post liquidation distributions to shareholders.

This part was generally well answered.

Question Four
Part (a) of this question examined tax residence rules for individuals, residence planning and the computation of tax payable under two alternative compensation packages.

Part (b), for five marks, was a test of ethics, involving tax offences by a taxpayer and his tax agent.

Both parts were satisfactorily answered.

Question Five
For 11 marks, part (a) tested the determination of real property company status, and the computation of real property gains tax.

Part (b), for the remaining nine marks, stated four situations which tested tax administration aspects of notification regarding employees leaving the country, a taxpayer's change of address, the right of appeal against an additional assessment and the availability of the right of appeal.

This question was generally well answered.

Examiner's report
ATX (MYS) Advanced Taxation
December 2018

The examining team share their observations from the marking process to highlight strengths and weaknesses in candidates' performance, and to offer constructive advice for future candidates.

General Comments

The examination consisted of Sections A and B, each with two compulsory questions. Section A contained Q1 for 35 marks and Q2 for 25 marks, while Section B contained two questions of 20 marks each.

Most candidates attempted all four questions. There was little evidence of time pressure. Where parts of questions were left unanswered by candidates, this appeared to be due to poor preparation, rather than insufficient time.

Some candidates demonstrated in their answers that they came relatively unprepared for the exam.

Specific Comments

Question One

This 35-mark question tested the application of research and development (R&D) incentives, reinvestment allowance and investment tax allowance. It required candidates to make a recommendation of which business entity within a group of companies should undertake the contemplated business activities.

Part (a) required candidates to discuss the available/relevant R&D incentives if an existing plantation company undertook the research activity or alternatively, if a new company was tasked with carrying out the research activity. This part was well responded to.

Part (b) revolved around a diversification project of commercialising the research outcome and candidates needed to consider the relative merits of an existing group company taking on the new product or incorporating a new company to do so. This part was fairly well responded to.

Part (c) called for the calculation of tax savings under each option. Surprisingly, this was not as well attempted as was expected. This was because candidates generally did not carry through what they had discussed in parts (a) and (b).

Part (d) required specific recommendations supported with reasons. The reasons were not well articulated.

Part (e) suggested a possible exit strategy within five years and asked candidates to consider if this would change their recommendation. Answers to this part were generally not well thought out even if candidates did allude to the attendant clawback under reinvestment allowance.

Question Two

This 25-mark question was satisfactorily answered.

Part (a) dealt with the issue of adventure in the nature of trade in three property transactions featuring different circumstances, and called for arguments for both for and against. This part was satisfactorily responded to as candidates were able to make their arguments based on the facts given in the question.

Part (b) involved the determination of whether the purported "hobby" of designing houses by an architect constituted business income. Very few candidates considered the definition of "business" in the Act. The requirement went on to ask whether work done for a Singapore client was derived in Malaysia. This part was also well responded to.

Part (c) linked the non-disclosure of the side income to the provisions for amended return leading to the self-assessed additional assessment in the Act [section 77B]. This part was not well responded to. Many candidates also did not distinguish between a lapsed year of assessment 2017 and the yet-to-come year of assessment 2018.

Question Three

Question 3 for 20 marks, was not well responded to.

Part (a) asked for the justification for a gas-piping system as "plant", and many candidates did not consider the functional test. The other issue of whether the total encasement of the existing pipes with bigger pipes was capital or revenue was better discussed.

Part (b) related to a current issue of an owner-operator's eligibility for industrial building allowance. Many candidates were unaware of the issue. Instead, they took the cue from the word ‘lease’ to discuss the treatment of leases.

Part (c) relating to goods and services tax (GST) was poorly responded to.

Question Four

Question 4, for 20 marks, was satisfactorily responded to.

Candidates fared well in part (a) on the real property gains tax (RPGT) issues of no-gain-no-loss. Many candidates were able to advise that the transfer of the building from Mas, the owner, to the company controlled by her should not be substantially for shares to avoid the no-gain-no-loss treatment.

In part (b) which tested knowledge of the implications of a company's repurchase of its own shares, many candidates produced fair but incomplete answers.

Part (c) relating to tax estimates, revised estimates and the penalty for excessive difference was well answered, with many candidates getting the full marks allocated to this part.

Strategic Professional – Options

Advanced Taxation – Malaysia (ATX – MYS)

March/June 2019 – Sample Questions

ATX MYS ACCA

Time allowed: 3 hours 15 minutes

This question paper is divided into two sections:

Section A – BOTH questions are compulsory and MUST be attempted

Section B – BOTH questions are compulsory and MUST be attempted

Tax rates and allowances are on pages 2–4

Do NOT open this question paper until instructed by the supervisor.

This question paper must not be removed from the examination hall.

ATX – MYS

Think Ahead ACCA

The Association of Chartered Certified Accountants

SUPPLEMENTARY INSTRUCTIONS

1. You should assume that the tax rates and allowances shown below will continue to apply for the foreseeable future.
2. Calculations and workings should be made to the nearest RM.
3. All apportionments should be made to the nearest whole month.
4. All workings should be shown.

TAX RATES AND ALLOWANCES

The following tax rates, allowances and values are to be used in answering the questions.

Income tax rates

Resident individual
Chargeable income

	RM	RM	Rate %	Cumulative tax RM
First	5,000	(0–5,000)	0	0
Next	15,000	(5,001–20,000)	1	150
Next	15,000	(20,001–35,000)	3	600
Next	15,000	(35,001–50,000)	8	1,800
Next	20,000	(50,001–70,000)	14	4,600
Next	30,000	(70,001–100,000)	21	10,900
Next	150,000	(100,001–250,000)	24	46,900
Next	150,000	(250,001–400,000)	24.5	83,650
Next	200,000	(400,001–600,000)	25	133,650
Next	400,000	(600,001–1,000,000)	26	237,650
Exceeding	1,000,000		28	

Resident company

Paid up ordinary share capital	First RM500,000	Excess over RM500,000
RM2,500,000 or less	18%	24%
More than RM2,500,000	24%	24%

Non-residents

Company	24%
Individual	28%

Labuan entity – income from a Labuan trading activity

All chargeable profits	3%

Trust body – resident or non-resident

All chargeable income	24%

Personal reliefs

		RM
Self		9,000
Disabled self, additional		6,000
Medical expenses expended on parents	(maximum)	5,000
Medical expenses expended on self, spouse or child with serious disease, including up to RM500 for medical examination	(maximum)	6,000
Parental care	(each)	1,500
Basic supporting equipment for disabled self, spouse, child or parent	(maximum)	6,000
Study course fees for skills or qualifications	(maximum)	7,000
Lifestyle allowance		2,500
Spouse relief		4,000
Disabled spouse, additional		3,500
Child – basic rate	(each)	2,000
Child – higher rate	(each)	8,000
Disabled child	(each)	6,000
Disabled child, additional	(each)	8,000
Childcare (below six years old)	(maximum)	1,000
Breastfeeding equipment	(maximum)	1,000
Life insurance premiums and contributions to approved funds	(maximum)	6,000
Private retirement scheme contributions, deferred annuity premiums	(maximum)	3,000
Medical and/or education insurance premiums for self, spouse or child	(maximum)	3,000
Deposit for a child into the National Education Savings Scheme	(maximum)	6,000
Contribution to Social Security Organisation (SOCSO)	(maximum)	250

Rebates

Chargeable income not exceeding RM35,000	**RM**
Individual – basic rate	400
Individual entitled to a deduction in respect of a spouse or a former wife	800

Capital allowances

	Initial allowance (IA) Rate %	**Annual allowance (AA) Rate %**
Industrial buildings	10	3
Plant and machinery – general	20	14
Motor vehicles and heavy machinery	20	20
Office equipment, furniture and fittings	20	10
Agriculture allowance		
Buildings for the welfare of or as living accommodation for farm employees	Nil	20
Other buildings used in the business	Nil	10
All other qualifying agriculture expenditure	Nil	50

[P.T.O.

Real property gains tax (RPGT)

	Companies	Individuals – non-citizens and non-permanent residents	All other persons
	Rate %	Rate %	Rate %
Category of disposal			
Disposal within three years after the date of acquisition	30	30	30
Disposal in the fourth year after the date of acquisition	20	30	20
Disposal in the fifth year after the date of acquisition	15	30	15
Disposal in the sixth year after the date of acquisition or thereafter	5	5	0

Goods and services tax (GST)

Standard rate	6%

Stamp duty

Rates of duty under the First Schedule
Conveyance, assignment, transfer or absolute bill of sale

	Rate %
Sale of property	
For every RM100 or fractional part thereof:	
On the first RM100,000	1
On the next RM400,000	2
On the excess over RM500,000	3
Sale of company shares	
On every RM1,000 or fractional part thereof	0·3

Section A – BOTH questions are compulsory and MUST be attempted

1 **Assume today's date is 4 June 2019.**

You are a tax associate of Tax Firm, and one of your clients is PandaiBuat Sdn Bhd (PBSB), a Malaysian resident company which manufactures air purifiers. Last week, your tax manager held a meeting with PBSB's chief financial officer, Mr Bok Chek Wai (Mr Bok), and took the following notes:

Notes from meeting with Mr Bok

- PBSB has paid up ordinary share capital of RM4·3 million, of which 75% is held by Malaysians and the remaining 25% is held by a foreign company.
- It started producing air purifiers in January 2017 at its Shah Alam, Malaysia manufacturing complex for the domestic market. Its domestic sales are wholly transacted through its wholly-owned subsidiary, Niaga Sdn Bhd (NSB), a company incorporated in Malaysia.
- NSB also exports rubber wood, and uses Malaysian banks, insurance companies and the Klang, Malaysia port facilities in its trading business.
- In the year of assessment (YA) 2019, PBSB started to export its air purifiers directly, i.e. not through NSB.
- The value-added rate is 40%.
- Both PBSB and NSB close their accounts annually to 30 April.

  Sales revenue for the financial year ended 30 April 2019, and the revenue forecasts for the following year are as follows:

	y.e. 30 April 2019 (actual) **RM'000**	**y.e. 30 April 2020 (forecast)** **RM'000**
PBSB		
Export sales of air purifiers	2,500	3,500
NSB		
Export of rubber wood	1,000	2,000
Domestic sales of air purifiers	9,500	9,500

- Mr Bok has approached your firm as he wants advice on whether it will be more advantageous for PBSB to continue exporting air purifiers directly, or to export the air purifiers through NSB. He would like to know the tax treatment and related tax issues for each option and your recommendation as to the best way to export the air purifiers in YA 2020.
- During the period January to March 2019, PBSB conducted a feasibility study regarding a plan to diversify into manufacturing air coolers. The study cost RM170,000.
- Following the positive outcome of the study, PBSB now intends to incur capital expenditure of RM2·75 million in March 2020 to set up an air cooler manufacturing facility (factory, plant and machinery) in its Shah Alam manufacturing complex. Mr Bok understands that this project will be eligible for the reinvestment allowance (RA).

[P.T.O.

Following the meeting, your tax manager has asked you to draft a report to PBSB addressing the following issues:

(a) PBSB's eligibility for the allowance for increased export (AIE)

(i) On the basis that PBSB exports the air purifiers directly, explain how PBSB fulfils the eligibility requisites for the AIE in YA 2020.

By the way, your tax manager has checked the law and found out that for exports with value added of at least 30% but not exceeding 50%, the allowance is 10% of the increase in exports.

(ii) Compute the tax savings from the AIE claimable by PBSB in respect of YA 2020.

(b) NSB's eligibility for the Malaysian international trading company (MITC) incentive

(i) Assuming NSB were to export the air purifiers, explain how NSB qualifies for certification as a MITC and is therefore eligible for the MITC incentive in the YA 2020.

(ii) Compute the tax savings from the MITC incentive claimable by NSB in respect of YA 2020.

(c) The diversification project

(i) Explain how PBSB is eligible for the reinvestment allowance (RA) in respect of the diversification into air coolers.

(ii) Compute the tax savings from the RA claimable by PBSB.

(d) Tax planning

Advise whether PBSB or NSB should export the air purifiers in YA 2020.

With regard to the diversification project, advise the best course of action in view of the mutual exclusion of the AIE and RA.

(e) Deductibility of the feasibility study costs

Consider whether the cost of the feasibility study carried out by PBSB would be treated as revenue or capital expenditure, and conclude as to its tax deductibility.

(f) Distribution of dividends by NSB

Assuming NSB claims the MITC incentive in YA 2020, and distributes both exempt dividends from an exempt account and single-tier dividends to its holding company PBSB, state:

- how much of each type of dividend may be distributed, and
- how each type of dividend is treated in the hands of PBSB.

For effectiveness, your tax manager has asked you to prepare a separate appendix to present the computations of tax savings in requirements (a)(ii), (b)(ii) and (c)(ii).

Required:

Draft the report to PandaiBuat Sdn Bhd (PBSB) as instructed by your tax manager.

The following marks are available:

(a) (i) PBSB's eligibility for the allowance for increased export (AIE). (4 marks)

(ii) Computation of tax savings. (3 marks)

(b) (i) Niaga Sdn Bhd's (NSB) eligibility for the Malaysian international trading company (MITC) incentive. (5 marks)

(ii) Computation of tax savings. (3 marks)

(c) (i) The reinvestment allowance (RA) available in respect of the diversification project. (5 marks)

(ii) Computation of tax savings. (2 marks)

(d) Tax planning regarding the choice of incentives by PBSB and NSB. (3 marks)

(e) Deductibility of the feasibility study costs. (3 marks)

(f) Tax treatment of distributions by NSB to PBSB by way of:

- **exempt dividends from exempt account; and**
- **single-tier dividends.** (3 marks)

Professional marks will be awarded in question 1 for adopting a logical approach, the appropriateness of the format and presentation of the report, and the effectiveness with which the information is communicated. (4 marks)

(35 marks)

2 You are a tax associate of Tax Firm. Mr Phoriner, a non-resident of Malaysia, called at the offices of your firm yesterday, and appointed Tax Firm as his tax agent. Your manager held a meeting with Mr Phoriner and took the following notes:

Notes of meeting with Mr Phoriner on 3 June 2019

– Mr Phoriner arrived in Malaysia for his first visit on 15 April 2019 and will leave on 18 July 2019. With effect from the year 2020, he intends to live in Malaysia for up to 100 days each year to develop his business interests in the country.

  Mr Phoriner would like to know how he can attain Malaysian tax residence status in the years 2020 to 2022 inclusive. He is highly flexible regarding the timing of his stays in Malaysia: visits may be any time during the year as long as visits total a maximum of 300 days in the three-year period from 1 January 2020 to 31 December 2022, due to Mr Phoriner's other commitments.

– Mr Phoriner is in the process of acquiring a warehouse building in Port Klang, Malaysia. The warehouse will cost RM838,000, which is below the market price of RM949,000, because the current owner needs a quick sale to avoid foreclosure by a lender. Mr Phoriner would like to know the stamp duty he will have to pay in connection with the acquisition of the warehouse assuming the purchase takes place on 1 July 2019.

– On 1 May 2019, Mr Phoriner, together with two Malaysian resident individuals, incorporated a company, Artsy Sdn Bhd (Artsy), and immediately commenced a business buying and selling art works. All three founder members are directors, each holding one-third of the ordinary paid up share capital of RM3·3 million. Artsy will close its first set of accounts to 30 June 2020, and thereafter to 30 June each year.

– With effect from 1 July 2019, Mr Phoriner will receive director's remuneration of RM11,500 a month, payable to his bank account in Singapore, and will also be provided with free accommodation by Artsy. The monthly rental cost of the accommodation, paid for by Artsy, will be RM13,000. The accommodation in Malaysia is provided exclusively for use by Mr Phoriner, and in his absence, by his immediate family when they are in Malaysia.

  Mr Phoriner stated that as he will not receive any cash payments in Malaysia, he should not be subject to income tax in Malaysia on his income from Artsy.

– Mr Phoriner will divert some of his professional fees earned overseas to Malaysia to service his loan repayment for the warehouse purchase. He expects to remit about RM100,000 into his Malaysian bank account in 2019 for this purpose.

Your manager has instructed you to prepare notes on the following issues which will be discussed with Mr Phoriner at the next meeting.

(a) Mr Phoriner's residence status

(i) Explain why Mr Phoriner will not be a Malaysian tax resident for the year of assessment (YA) 2019.

(ii) Considering his flexibility on the timing of days spent in Malaysia, explain how Mr Phoriner can achieve Malaysian tax residence status for YAs 2020 to 2022 by pre-planning his visits to Malaysia.

(b) Basis periods for Artsy

(i) Determine the basis periods for Artsy for the YAs 2019, 2020 and 2021.

(ii) Identify the first YA for which the following income tax compliance requirements will apply for Artsy:

– provision of a tax estimate,
– payment of tax instalments, and
– submission of an annual tax return

and state the deadlines for each of these compliance requirements.

(c) Stamp duty

Compute the stamp duty payable by Mr Phoriner on the purchase of the warehouse property on 1 July 2019.

(d) Income tax payable

Compute the income tax payable by Mr Phoriner for YA 2019, and include explanations of how each item of income included in the information above is treated for Malaysian income tax purposes. You should consider the availability of personal reliefs to Mr Phoriner.

Required:

Carry out the work as instructed by your tax manager.

The following marks are available:

(a) (i)	**Residence status of Mr Phoriner for YA 2019.**	(2 marks)
(ii)	**Residence planning for the YAs 2020 to 2022.**	(5 marks)
(b) (i)	**Basis periods for Artsy Sdn Bhd for the YAs 2019 to 2021.**	(3 marks)
(ii)	**Compliance requirements.**	(4 marks)
(c)	**Stamp duty.**	(2 marks)
(d)	**Income tax payable.**	(9 marks)
		(25 marks)

[P.T.O.

Section B – BOTH questions are compulsory and MUST be attempted

3 (a) LGE Sdn Bhd (LGE) acquired two commercial buildings, a warehouse and a retail outlet, in Selangor, Malaysia for a total cost of RM15 million during the financial year ended 31 December 2017.

The first building, a warehouse, was let throughout the financial year ended 31 December 2018 for a monthly rent of RM12,000. The tenant uses the warehouse in its business of providing storage space to the public. LGE is required to provide comprehensive repair, maintenance, cleaning and security of the property during the tenancy period.

The second building, a retail outlet, was first let on 1 July 2018 to CKT Sdn Bhd (CKT) for use as a restaurant at a monthly rent of RM10,000 for a period of three years.

Under the tenancy agreement, CKT is required to pay:

– No rent for the first two months to allow CKT to undertake renovation works
– On 1 September 2018, one month utility deposit together with one year's advance rent of RM120,000.

LGE incurred legal fees of RM10,000 in May 2018 in relation to advice taken on the tenancy agreement.

LGE is required to install moveable partitions at the back portion of the building to configure eight private dining rooms and to provide one security guard throughout the tenancy period with effect from 1 July 2018 but does not provide repair, maintenance or cleaning services.

Required:

Explain how the rental income received by LGE Sdn Bhd in respect of the letting of the two commercial buildings during the year of assessment 2018 will be taxed in Malaysia, and also the tax treatment of the rental expenses and building expenditure. (8 marks)

(b) Tony recently commenced employment with TP REIT (TPR), a real estate investment trust (REIT) listed on Bursa Malaysia, as its financial controller. TPR has a portfolio of commercial properties in Klang Valley, Malaysia and Singapore. Investors in TPR include Malaysian resident and non-resident companies and resident and non-resident individuals.

For the financial year ended 31 May 2019, TPR had the following income:

	RM'000
Statutory rental income	5,000
Dividend income from Singapore	1,000

During the financial year, TPR made a cash donation of RM500,000 to an approved institution. In the prior year, TPR's deductible expenses exceeded its rental income by RM800,000.

Tony understands that the REIT will be exempt from income tax if it distributes enough of its profits to its unit holders.

Required:

(i) Describe the special tax treatment accorded to a REIT compared to a property investment company carrying out a business of letting property from the perspective of:

- **Deductibility of expenses;**
- **Deductibility of donations; and**
- **Eligibility to carry forward tax losses/capital allowances.** (5 marks)

(ii) Compute the amount of total income TP REIT (TPR) is required to distribute for the year of assessment 2019 to qualify for the income tax exemption available for REITs. (2 marks)

(iii) Explain the tax treatment for the different types of unit holders of the distributions made to them by TPR based on the assumption that TPR qualifies for the REIT income tax exemption. (5 marks)

(20 marks)

4 **(a)** Timothy, a Malaysian citizen, owned a piece of commercial land. The following information is available in relation to Timothy's ownership of the land:

(1) Timothy inherited the land from his father's estate when his father died on 10 December 2008. On this date, the market value of the land was RM900,000. The land had been acquired by Timothy's father in 2000 for RM300,000. The executor transferred the land to Timothy on 4 April 2011 when its market value was RM1,000,000.

(2) In 2012, Timothy constructed a warehouse on the land for RM1,200,000, funded by a loan which he repaid in full in 2014. The total interest expense he incurred on the loan amounted to RM80,000. On 10 May 2014, Timothy received compensation of RM2,500,000 from his neighbour who had caused significant damage to the land such that the entire warehouse needed to be demolished. In January 2015, Timothy constructed a new warehouse building on the land for RM800,000.

(3) Timothy then transferred the commercial property to his daughter, Joanna, as her wedding gift on 30 March 2015, when the market value of the property was RM1,800,000.

(4) Joanna subsequently sold the property for RM2,800,000. The sale and purchase agreement, dated 14 March 2019, was conditional upon obtaining consent from the State Government which was obtained on 19 May 2019.

Required:

Explain the real property gains tax (RPGT) implications of the property transactions (1) to (4) above for Timothy and Joanna. Wherever relevant, compute the disposal price, acquisition price and RPGT liability arising. (10 marks)

(b) Malas Patuh Sdn Bhd (MPSB), which closes its accounts to 31 December each year, has not filed income tax returns since its incorporation on 4 May 2011 because the company had only incurred losses. As the company became profitable in the year of assessment 2018, it filed its first income tax return on 15 May 2019, reporting an income tax liability of RM50,000 (before taking account of past losses).

On 28 May 2019, the Inland Revenue Board (IRB) issued estimated assessments of RM50,000 for each of the years of assessment 2011 to 2017.

Required:

(i) State, with reasons, whether the Inland Revenue Board (IRB) is authorised to issue the assessments for the years of assessment 2011 to 2017. (3 marks)

(ii) Explain how Malas Patuh Sdn Bhd can appeal for the discharge of the assessments, and state whether the past losses can be brought forward and utilised against the profits of the company after the year of assessment 2017. (3 marks)

(c) Gading Sdn Bhd (GSB), a GST registrant, provides management services and holds investments. GSB receives an annual management fee of RM1 million from its subsidiaries, and annual dividend income ranging from RM300,000 to RM500,000 depending on the performance of the subsidiaries. In addition, when GSB had surplus cash, it invested in short-term bank deposits with local banks and receives interest income.

To support its activities, GSB incurred direct expenses in relation to the provision of management services, and common overheads for the overall management of the company.

Required:

Explain the goods and services tax (GST) implications of the supplies made by Gading Sdn Bhd and how the input tax attributable to the expenses incurred will be treated. (4 marks)

(20 marks)

End of Question Paper

1 Report to PandaiBuat Sdn Bhd

From Tax Firm
To Mr Bok Chek Wai, Chief financial officer, PandaiBuat Sdn Bhd
Date 4 June 2019

This report considers the key tax issues of PandaiBuat Sdn Bhd (PBSB) and Niaga Sdn Bhd (NSB) arising from increased exports and PBSB's diversification project.

(a) (i) PBSB's eligibility for the allowance for increased export (AIE)

PBSB satisfies the following requirements for AIE:

– PBSB is a resident company engaged in the manufacture of air purifiers for both the domestic and export markets.

– PBSB expects to register export sales of RM3·5 million in YA 2020. This represents a 40% increase in value added [(3,500,000 – 2,500,000)/2,500,000] over the YA 2019 export sales. The rate of the AIE for PBSB will therefore be 10% of the value of increase in export sales in YA 2020 over that of the preceding year (YA 2019).

However, there is a non-application clause for AIE, if the company is granted incentives under the Promotion of Investments Act or reinvestment allowance under the Income Tax Act.

(ii) Tax savings

Please refer to the appendix for the tax savings arising from the claim of AIE.

(b) (i) Eligibility for the Malaysian international trading company (MITC) incentive

NSB fulfils the following conditions for certification as an MITC for the year of assessment (YA) 2020:

– NSB is incorporated in Malaysia.

– NSB is wholly owned by PBSB, which is 75% held by Malaysians. NSB is therefore effectively 75% held by Malaysians. This exceeds the minimum requirement of 60%.

– For YA 2020, if NSB were to export the air purifiers, it expects to have sales revenue of RM15 million (RM2 million + RM9·5 million + RM3·5 million) which exceeds the minimum requirement of RM10 million annual sales for an MITC.

– Of its total sales, rubber wood sales of RM2 million will constitute 13·3% (2 million/15 million) of total sales of NSB. This fulfils the requirement that no more than 20% of its sales revenue comes from the trading of primary commodities.

– As NSB uses Malaysian banks, insurance companies and Klang port facilities, it also fulfils the requirement that an MITC uses local services for the purposes of banking, finance and insurance and uses local ports and airports.

Therefore, NSB is likely to succeed when it applies to the Malaysian External Trade Development Corporation (MATRADE) for certification as an MITC. With such a letter from MATRADE, NSB will be eligible for the MITC incentive.

(ii) Tax savings

Please refer to the appendix for the tax savings arising from the claim of the MITC incentive.

(c) (i) The diversification project

PBSB is eligible for the reinvestment allowance (RA) in respect of the diversification into air coolers because it fulfils the following conditions:

– PBSB is a resident company in Malaysia;

– It has been manufacturing since January 2017;

– By March 2020, when the capital expenditure will be incurred, it would satisfy the minimum 36 months' operation condition;

– It will incur capital expenditure of RM2·75 million on a factory, plant and machinery used in Malaysia;

– PBSB is embarking on a qualifying project of diversification for the purposes of RA.

However, PBSB will not qualify for RA if it claims the AIE, as the two incentive measures are mutually exclusive.

(ii) Tax savings

Please refer to the appendix for the tax savings arising from the claim of RA.

(d) Tax planning

The tax saving accruing to NSB in claiming the MITC incentive amounts to RM216,000. This compares very favourably to PBSB claiming AIE, which yields a tax saving of only RM24,000.

Moreover, if PBSB were to claim AIE, it would not be eligible for RA in YA 2020. Considering the RA yields a hefty tax saving of RM396,000 compared to RM24,000 (for AIE), it is clear that PBSB should not claim AIE.

We recommend therefore that NSB should take on the exporting of the air purifiers, and claim the MITC incentive. PBSB will then be in a position to claim RA in YA 2020.

(e) Deductibility of the feasibility study costs

The feasibility study costing RM170,000 may be argued to be revenue in nature because the products (i.e. air purifiers and air coolers) are related; the latter is merely an extension of the existing business. It is incurred during the process of producing income from manufacturing and therefore constitutes a tax deductible revenue expense.

On the other hand, the expenditure pertains to a new product and was incurred during the pre-production period. Therefore, the feasibility study helps put the company in a position to decide on the launching of a new product. Viewed thus, it is not incurred in the process of producing income, but incurred in order to produce the income, it is clearly capital in nature.

On balance, we are of the view that the feasibility study expenditure is capital in nature, and is not tax deductible.

Alternative acceptable conclusion
On balance, we are of the view that the feasibility study expenditure is revenue in nature, because the two products are closely related, pertaining to the same source of business, and is directly related to the income-earning process, therefore tax deductible.

(f) Distribution of dividends by NSB

Assuming that NSB claims the MITC incentive in the YA 2020 and distributes both exempt dividends and single-tier dividends to its holding company PBSB:

– The amount of single-tier dividends which can be distributed by NSB will be restricted to the availability of its retained earnings.

  In the hands of PBSB, a single-tier dividend will be specifically exempt under the law [under paragraph 12B, Schedule 6].

– The amount of exempt dividends which can be distributed will similarly be restricted to the availability of retained earnings. It is additionally restricted to the amount of the MITC incentive of RM216,000, when it is fully absorbed against the statutory income of NSB.

  PBSB will be exempt from tax in respect of this dividend. PBSB in turn can distribute exempt dividends of up to RM216,000 to its shareholders, who will also be tax exempt under the two-tier exempt dividend provisions.

End of report

Appendix

Tax savings of the three incentive measures in YA 2020

	RM'000	RM'000
(a) (ii) PBSB's claim for AIE		
Value of exports in YA 2019		
Export of air purifiers	2,500	
Value of exports in YA 2020		
Export of air purifiers	3,500	
Value of increased exports		1,000
Value added = 40% Therefore, tax exemption is 10% of increased exports of RM1 million, to be set off against 70% of statutory income until fully absorbed		100
Tax saving at 24%		24
(b) (ii) NSB's claim for the MITC incentive		
Value of exports in YA 2019		
Export of rubber wood		1,000
Value of exports in YA 2020		
Export of air purifiers	3,500	
Export of rubber wood	2,000	5,500
Value of increased exports		4,500
Tax exemption: 20% of increase in exports To be set off against 70% of statutory income until fully absorbed		900
Tax savings at 24%		216
(c) (ii) PBSB's claim for RA		
Qualifying capital expenditure (QCE)		2,750
RA at 60% of QCE of RM2·75 million To be set off against 70% statutory income until fully absorbed		1,650
Tax saving at 24%		396

2 (a) (i) Mr Phoriner – Residence status for year of assessment (YA) 2019

Mr Phoriner's stay in Malaysia in 2019 is 95 days (15 April 2019 to 18 July 2019).

He will not be able to satisfy the 182-day rule or the other rules as he has no prior pattern of stay in Malaysia.

Therefore, Mr Phoriner will be non-resident in Malaysia for YA 2019.

(ii) Mr Phoriner – Residence planning

YAs 2020 and 2021

Given that he is flexible in his timing and pattern of stay, Mr Phoriner could qualify for tax residence in Malaysia in YAs 2020 and 2021 by linking a shorter period of stay in one year ('the short period') to a longer period of at least 182 days ('the long period') in the immediately preceding or immediately following year. This means one of the following:

1. A continuous stay from 3 July 2020 to 31 December 2020 (182 consecutive days), linked to 1 January 2021; or
2. A continuous stay from 31 December 2020 (1 day) linked to the consecutive 182-day period of 1 January 2021 to 1 July 2021.

In this way, Mr Phoriner will qualify for residence under the 182-day rule [s.7(1)(a)] for the year with 'the long period', while the year with 'the short period' will qualify for residence under the linkage rule [s.7(1)(b)].

YA 2022

If Mr Phoriner is present in Malaysia for an aggregate of at least 90 days throughout the year 2022, he will qualify for tax residence under the rule [s.7(1)(c)]. This rule stipulates that he is in Malaysia for at least 90 days in 2022, and he is in Malaysia for at least 90 days or resident for three out of the four immediately preceding years. This will be satisfied by Mr Phoriner as seen below:

2019	95 day stay (exceeded the minimum requirement of 90 days)
2020	Resident (182-day rule or linkage rule)
2021	Resident (182-day rule or linkage rule)
2022	In Malaysia for at least 90 days, and has 90 day stay in 2019, is resident for YAs 2020 and 2021

(b) Basis periods for Artsy Sdn Bhd for the YAs 2019 to 2021

Artsy will close its accounts as follows:

- 1 May 2019 (date of incorporation and commencement of operations) to 30 June 2020;
- 1 July 2020 to 30 June 2021; and
- Thereafter to 30 June annually.

YA	Basis period	Compliance requirement
2019	No basis period because no accounts close in the year 2019	No compliance requirement.
2020 First YA for tax compliance requirements.	1 May 2019 to 30 June 2020	1. Artsy needs to provide an estimate of tax for YA 2020 by 31 July 2019 (i.e. within three months of its commencement of operations). 2. 14 equal monthly tax instalments will be payable from October 2019 until November 2020 (i.e. from the sixth month after the commencement of operations). 3. The tax return for YA 2020 will be due for submission by 31 January 2021 (i.e. by the end of seven months after the close of accounts on 30 June 2020).
2021	1 July 2020 to 30 June 2021	Not applicable.

(c) Stamp duty

Although the warehouse building was acquired for RM838,000, the stamp duty payable is calculated based on the market value of RM949,000, as follows:

	RM
First 100,000 at 1%	1,000
Next 400,000 at 2%	8,000
Remaining 449,000 at 3%	13,470
Total	22,470

(d) Computation of Mr Phoriner's income tax payable for YA 2019

	RM'000	RM'000
Director's remuneration (Note 1)		
RM11,500 x 6 months		69,000
Accommodation benefit from employer:		
RM13,000 x 6 months (Note 2)	78,000	
No restriction to 30% of remuneration		78,000
Remittance of foreign-sourced income (Note 3)		Exempt
Aggregate/Total income		147,000
No personal reliefs (Note 4)		Nil
Chargeable income		147,000
Tax at 28% (Note 4)		41,160

Notes

1. Mr Phoriner's director's remuneration is deemed derived from Malaysia as it is paid by a company resident in Malaysia and is therefore taxable in Malaysia.
2. Where free accommodation is provided to a non-service director of a controlled company, the accommodation benefit is not restricted to the 30% of employment income [(under s.13(1)(a)]. Artsy is a controlled company because it is controlled by three (not more than five) shareholders. Mr Phoriner owns 33% of the share capital of Artsy, so he is a non-service director (more than 5% of share capital) of Artsy.
3. Foreign-sourced income, when remitted to Malaysia, is specifically [Paragraph 28, Schedule 6] exempt from income tax.
4. As Mr Phoriner is non-Malaysian tax resident in YA 2019, he is not entitled to any personal reliefs, and he is subject to income tax at the fixed rate of 28%.

3 (a) LGE Sdn Bhd (LGE)

Treatment of rental income, expenses and building expenditure

Warehouse

Rental income – As LGE provides comprehensive maintenance and support services to the tenant, the rental income can be treated as business income [s.4(a)].

Rental expenses – As the property is rented out throughout the rental period, all the expenses (i.e. quit rent and assessment, security guard as well as repair, maintenance and cleaning expense) incurred in the production of the rental income are tax deductible.

Building expenditure – As the warehouse is used by the tenant in its business of providing storage space to the public, the warehouse is eligible for industrial building allowance (IBA). The applicable initial and annual allowance rates are 10% and 3% respectively.

[Tutorial note: *It should be noted that the disqualification of an IBA claim for special industrial buildings [under Paragraph 16B, Schedule 3] to landlords who are non-operators is not relevant as a warehouse used for storage of goods by the public is not specifically excluded.*]

Restaurant

Rental income

LGE is only providing security services to the tenant. It cannot be said that LGE is providing comprehensive maintenance and support services and hence, the rental income should be treated as passive rental income [s.4(d)].

The utility deposit received is not taxable; it does not form part of the income of the company, as it will be refunded at the end of the tenancy.

As LGE has received advance rental income for one year, the total amount of RM120,000 received must be brought to tax in YA 2018 [s.27].

Rental expenses

As the tenancy period only commenced on 1 July 2018, expenses incurred prior to that date are not tax deductible. The legal fees relating to the tenancy agreement are therefore not tax deductible. The security guard expenses from 1 July 2018 onwards are deductible, notwithstanding that rent is only charged from 1 September 2018 onwards.

Building expenditure

As the building is used as a restaurant, the building expenditure does not qualify for IBA. Conceptually, the moveable partitions can qualify as plant, but as the rental source is passive, no capital allowances are due.

(b) TP REIT (TPR)

(i) Special tax treatment for TPR

Deductibility of expenses

As the rental income is treated as a business source, all expenses or outgoings incurred wholly and exclusively in the production of rental income are tax deductible. In this respect, the tax deductibility rules are similar to that of a property investment company carrying on a business of letting property.

Deductibility of donations

Deductions in respect of cash donations made by TPR to approved institutions are restricted to 7% of aggregate income. In the case of a property investment company, the restriction rate is 10%.

Eligibility to carry forward of capital allowances and tax losses

Notwithstanding that the rental income is treated as a business source for TPR, it is specifically provided that any unabsorbed capital allowances, and excess of tax deductible expenses over income, cannot be carried forward for set off against future taxable profits. However, for a property investment company, any unutilised capital allowances and losses can be carried forward for set off against future taxable profits under normal tax rules.

(ii) Amount of total income to be distributed to be eligible for REIT income tax exemption

In order for a REIT to be tax exempt, it must distribute at least 90% of its total income. Therefore, for YA 2019, TP REIT must distribute at least RM4,185,000 to be eligible for the income tax exemption.

	RM'000
Statutory rental income	5,000
Dividend income from Singapore	Nil
Aggregate income	5,000
Less: Approved donation (restricted to 7%)	(350)
Total income	4,650
90% of total income	4,185

(iii) Tax treatment of distributions from REIT to unit holders

Assuming that TPR qualifies for the REIT income tax exemption [s.61A], the tax treatment of REIT distributions in the hands of the unit holders is as follows:

– **Malaysian resident companies**
In respect of the income exempt from income tax under the REIT exemption [s.61A], TPR will pay the gross distribution amount in full without any withholding tax at source.

The resident company must report the gross distribution in its annual tax return. The tax rate applicable to such a REIT distribution is the tax rate/s applicable to the recipient company (i.e. at the standard rate of 24% or a combination of the 18% and 24% rates depending on whether the recipient company is a small or medium enterprise, as defined).

– **Malaysian resident individuals**
TPR is required to withhold tax at 10% at source from the distribution and pay over the tax withheld to the Director General within one month after the date of the distribution.

The individuals are not required to report the distribution in their annual tax return. Therefore, the 10% tax withheld represents the final tax on the REIT income for the individual unit holders.

– **Non-Malaysian resident companies**
The tax treatment of the distribution by TPR to non-resident companies is similar to that for residential individuals except that the applicable rate is 24%.

– **Non-Malaysian resident individuals**
The tax treatment of the distribution by TPR to individual unit holders who are non-resident in Malaysia is similar to that for resident individual unit holders (i.e. 10% withholding tax at source as the final tax).

Where the TPR distributes out of dividend income from Singapore, which is exempt from Malaysian tax, the income distributed is not taxable, regardless of the status of the unit holders.

4 (a) Timothy and Joanna

Inheritance of land by Timothy
When the executor transferred the land to Timothy, being the beneficiary of his father's estate, the land is treated as acquired by Timothy on 4 April 2011 (i.e. the date the land is transferred to him). The acquisition price is the market value of the land at the date of transfer of the land (i.e. RM1,000,000).

Receipt of compensation for damage to the land on 10 May 2014
The compensation received by Timothy for the damage caused to the land must be deducted from the acquisition consideration of the property. Where the sum received exceeds his acquisition price, the amount of the excess shall constitute a chargeable gain accruing to Timothy at the time when he receives that sum.

	RM
Acquisition price	1,000,000
Less: Compensation received	(2,500,000)
Deemed chargeable gain	1,500,000
Acquisition date: 4 April 2011	
Disposal date: 10 May 2014	
RPGT rate: 20% (fourth year of acquisition)	300,000

Thereafter, the acquisition price of the property in relation to any subsequent disposal of that asset, shall be taken as nil.

Gift of property by Timothy to Joanna
Where a donor disposes an asset by way of a gift to a recipient, the disposal shall be taken to be the market value.

However, the transaction shall be deemed to be a 'no-gain-no-loss' (NGNL) transaction where:

– the donor is a Malaysian citizen, and

– the donor and the recipient are parent and child, and provided that

– the gift is made within five years of acquisition of the asset.

As the gift is made by Timothy to Joanna in the fourth year of acquisition (acquisition date – 4 April 2011; disposal date – 30 March 2015), the transaction shall be regarded as a NGNL transaction.

Joanna shall be deemed to acquire the asset at an acquisition price equal to the acquisition price paid by Timothy plus any permitted expenses incurred by Timothy.

	RM
Acquisition price to the donor (i.e. Timothy)	Nil
Permitted expenses – construction of warehouse	800,000
Acquisition price to Joanna	800,000

Disposal of property by Joanna

The disposal of the property by Joanna will be subject to RPGT. As the sale agreement of 14 March 2019 is conditional upon the State Government's consent, the date of disposal will therefore be determined when the State Government's consent was obtained (i.e. 19 May 2019).

The RPGT liability for the disposal is computed as follows:

	RM
Disposal price	2,800,000
Less: Acquisition price	(800,000)
Chargeable gain	2,000,000
Less: Exemption (RM10,000 or 10% of chargeable gain)	(200,000)
Gain subject to RPGT	1,800,000
Disposal date: 19 May 2019	
Acquisition date: 30 March 2015	
RPGT liability (15% i.e. fifth year of acquisition)	270,000

(b) Malas Patuh Sdn Bhd (MPSB)

(i) Every company in Malaysia is required to file an annual income tax return for each year of assessment, regardless of whether the company is profitable or loss making.

Where a person for a year of assessment has not furnished a return, the Director General of Inland Revenue (DGIR) may, according to the best of his judgement, determine the amount of the chargeable income of that person for that year and make an assessment accordingly [s.90(3)].

Therefore, the Inland Revenue Board (IRB) is authorised to make estimated assessments on MPSB.

Generally, there is a time limit of five years for the DGIR to raise assessments or additional assessments unless it appears to him that any form of fraud or wilful default has been committed or the person has been negligent, in which case there is no time bar [s.91].

Since MPSB has been negligent in failing to submit tax returns, the time limit of five years is not applicable; the assessments raised by the IRB from the years of assessment 2011 to 2017 are valid.

(ii) As MPSB has already been served with the notices of assessment, the company must appeal in writing by 26 June 2019 (i.e. within 30 days from the date of the notices of assessment). In the appeal, MPSB must clearly set out the grounds for the appeal. MPSB should prepare and submit the tax computations for the years of assessment 2011 to 2017, showing that the company was loss-making, and, hence, has no tax payable.

The DGIR will then review the case; if they are satisfied that there was no tax payable, they will issue reduced assessments to discharge the tax liability for the relevant years.

However, in practice, the DGIR will likely maintain the penalty for the non-submission of tax returns.

[**Tutorial note:** *The maintenance of the penalty in a non-liable case appears to run contrary to s.112(3) which states that the penalty shall be treble the amount of tax charged.*]

The tax losses computed can be carried forward to be utilised against future profits of the company.

(c) Goods and services tax (GST)

The provision of management services is treated as a taxable supply for GST purposes. Dividend income received by Gading Sdn Bhd (GSB) is out of scope of GST, and interest received from bank deposits is an exempt supply.

As GSB has both taxable and exempt supplies, the company would be treated as a mixed supplier. It should be noted that the interest income cannot be treated as incidental financial exempt supplies because the rules applicable to incidental financial exempt supplies specifically exclude an investment holding company. Accordingly, GSB cannot be treated as a wholly taxable supplier.

As a mixed supplier, GSB is not eligible to claim the full amount of input tax incurred. The input tax relating to expenses which are directly attributable to the provision of management services, being a taxable supply, can be claimed in full. However, the common expenses relating to both taxable and exempt supplies have to be apportioned, and only the portion relating to the taxable supplies can be claimed.

				Marks
1	(a)	(i)	**AIE incentive**	
			How PBSB eligible for AIE	
			Resident, manufacturing	0·5 + 0·5
			Increase in exports and applicable rate	2 + 1
			Mutual exclusion with RA	1
			Available	5
			Maximum	4
		(ii)	Computation of tax savings – AIE	3
	(b)	(i)	**MITC incentive**	
			How NSB fulfills MITC conditions 5 x 1	5
			Certificate from MATRADE	1
			Available	6
			Maximum	5
		(ii)	Computation of tax savings – MITC	3
	(c)	(i)	**Diversification project – RA**	
			Why eligible for RA 5 x 1	5
			Exclusion	1
			Available	6
			Maximum	5
		(ii)	Computation of tax savings – RA	2
	(d)		**Tax planning**	
			NSB claiming MITC incentive – tax saving	1
			PBSB claiming AIE – tax saving	1
			Mutual exclusion with RA	1
			Conclusion	1
			Available	4
			Maximum	3
	(e)		**Deductibility of feasibility study**	
			Arguments for deductibility	1·5
			Arguments for non-deductibility	1·5
			Conclusion	1
			Available	4
			Maximum	3
	(f)		**Distribution of dividends**	
			Single-tier dividend, restricted to retained earnings, exempt under law	1 + 1
			Exempt dividend, restricted to retained earnings and exempt account, 2-tier	2
			Available	4
			Maximum	3
	Professional marks			
	Format and presentation of the report			1
	Clarity and effectiveness of communication including logical flow			2
	Approach to problem solving			1
				4
				35

				Marks
2	**Mr Phoriner and Artsy Sdn Bhd**			
	(a)	**(i)** Phoriner – residence status for YA 2019		2
		(ii) **Residence planning**		
		YAs 2020 and 2021		1 + 1 + 1 + 1
		YA 2022		1 + 1
			Available	6
			Maximum	5
	(b)	**(i)** Basis periods for YAs 2019 to 2021 1 x 3		3
		(ii) Compliance requirements		4
	(c)	**Stamp duty**		
		Market value		1
		Calculations		1
				2
	(d)	**Computation of tax payable**		
		Director's remuneration, amount, why derived in Malaysia even though paid to Singapore		1 + 1 + 1
		Accommodation benefit: amount, why no restriction to 30%: controlled company, non-service director		1 + 1 + 0·5 + 0·5
		Foreign income remitted: exempt		1
		Taxed as non-resident: no reliefs, fixed rate of 28%		1 + 1 + 1
			Available	10
			Maximum	9
				25
3	**(a)**	**Warehouse**		
		Rental income		1
		Rental expenses		1
		Building expenditure		0·5 + 0·5
		Restaurant		
		Rental income – advance income/utility deposit		1 + 0·5
		Rental expenses – deductibility pre-rental/significance of 1 July 2018		1 + 1
		Building expenditure/partition		1 + 1
			Available	8·5
			Maximum	8
	(b)	**(i)** **TP REIT**		
		Deductibility of expense/donation		1·5 + 1·5
		Eligibility to carry forward CA/losses		1 + 1
				5
		(ii) Rate of distribution		0·5
		Computation		1·5
				2
		(iii) **Distribution from income exempted under REIT tax exemption**		
		Resident company (gross distribution/taxed at unit holders)		0·5 + 0·5
		Resident individual (WHT/final tax)		0·5 + 0·5
		Non-resident company (WHT/final tax)		0·5 + 0·5
		Non-resident individual (WHT/final tax)		0·5 + 0·5
		Distribution of income from foreign dividend		1
				5
				20

			Marks
4	**(a)**	**Timothy and Joanna**	
		Acquisition from father's estate (acquisition date/price)	1 + 1
		Receipt of compensation for injury to land	
		Treatment	1
		Computation of deemed chargeable gain	2
		Disposal by way of gift	2
		Disposal of property	
		Treatment	1
		Computation of RPGT liability	2·5
		Available	10·5
		Maximum	10
	(b)	**Malas Patuh Sdn Bhd**	
		(i) Need to file whether profit or loss	1
		DG empower to issue assessment based on best judgement	1
		Time limit not applicable	1
			3
		(ii) Appeal within 30 days	1
		Specify grounds of appeal, submit tax computations with nil tax	0·5 + 0·5
		DG review and discharge liability, penalty may stay	0·5 + 0·5
		Losses can be used	1
		Available	4
		Maximum	3
	(c)	**GST**	
		Output tax treatment for each category	0·5 + 0·5 + 05
		Mixed supply/not qualify as IFES	1 + 0·5
		Input tax treatment	0·5 + 1
		Available	4·5
		Maximum	4
			20

Examiner's report

ATX-MYS Advanced Taxation
June 2019

The examining team share their observations from the marking process to highlight strengths and weaknesses in candidates' performance, and to offer constructive advice for future candidates.

General Comments

The examination consisted of Sections A and B, each with two compulsory questions. Section A contained Q1 for 35 marks and Q2 for 25 marks, while Section B contained two questions of 20 marks each.

Most candidates attempted all four questions. There was little evidence of time pressure. Where parts of questions were left unanswered by candidates, this appeared to be due to incomplete preparation, rather than to insufficient time.

This is an advanced level exam, building upon the knowledge and skills examined in TX MYS, Taxation. At this advanced stage candidates will be required to digest information quickly, and apply relevant knowledge and understanding in coming up with a response to the given scenario. Section A, comprised of Q1 and Q2, will include moderately complex practical business scenarios. Candidates are expected to understand, deal with, recommend and communicate the strategic and technical issues that a tax professional may encounter.

Candidates sometimes lost marks by failing to respond fully to the question requirements, or through failure to take account of important details in the question scenarios. Candidates are urged to read question scenarios with great care and to pay particular attention to the exact question requirements, so that they do not provide irrelevant responses.

Generally, the level of preparedness and technical competence was pleasing. Candidates performed best on questions 1 and 2.

Specific Comments

Question One

This 35-mark question was based on a manufacturer with a trading subsidiary, and tested candidates' knowledge of export incentives vis-a-vis reinvestment allowance against a backdrop of increased exports and diversification.

Parts (a), (b), and (c), required candidates to explain why and how the relevant companies qualified for the allowance for increased exports, the Malaysian International trading company incentive, and reinvestment allowance. They were also asked to compute the tax savings in each case. Part (d) followed up by requiring candidates to tax plan and recommend the best course of action as to which company should undertake the export activity and claim which tax incentive.

Most candidates performed competently in parts (a) to (d). It was demonstrably clear that well prepared candidates had no difficulties in applying their knowledge to the scenario. It was pleasing to see that candidates both laid down the general conditions and then also applied their knowledge to the scenario by explaining how the companies fulfilled those conditions.

Part (e) required candidates to determine the deductibility of the cost of feasibility studies in connection with the diversification project, while part (f) followed through to the distribution of dividends by the trading subsidiary and the tax treatment in the hands of the parent. These sections proved more challenging for most candidates.

Part (e) regarding the deductibility of the cost of feasibility studies was not well argued out while the treatment of exempt dividends and single-tier dividends was somewhat inconsistent. Candidates should think clearly about the distributing company and about the tax treatment in the hands of the recipient.

Question Two

This 25-mark question covered the topics of tax residence for an individual, residence planning, the basis periods for a newly-commenced company, stamp duty, and the computation of tax charged for a non-resident individual.

Part (a) required candidates to determine the residence status of an individual for 2019, and then to explain how he could plan, over the next three years, to achieve tax residence in Malaysia.

Part (b) concerned a new business venture structured as a limited company started by the individual. Candidates were required to determine the basis periods for the first three years of assessment and explain the tax compliance requirements.

Part (c) requires the application of market value in a stamp duty context and the computation of the stamp duty in the acquisition of a real property.

Part (d) asked candidates for the computation of the tax liability of the non-resident individual deriving income from Malaysia and overseas.

Candidates generally performed well for parts (a) to (c), but not so well in part (d). Despite the fact that part (d) involved computations, it was evident that candidates had not revised fundamental tax topics from their earlier studies, and they are reminded that this should be an essential part of their preparation for the ATX exam.

Question Three

This 20-mark question tested in part (a) the taxation of income from the letting of properties and in part (b), the taxation of Real Estate Investment Trust (REIT).

Part (a) tested the classification of income under business or rental per se, deductibility of expenses, timing of income recognition of an amount received in advance, and eligibility for industrial building allowance.

The classification as business income and rental income was handled well, but the deductibility of legal expenses on the initial tenancy agreement, security guards and renovations was not so clearly understood.

Part (b)(i) required a comparison between a REIT and a property investment company, which many candidates read as "investment holding company". Some confusion was demonstrated about whether capital allowance and losses may be carried forward. This indicates that candidates did not fully understand the taxation of REITs.

Part (b)(ii) took a somewhat different perspective by asking for the amount of distribution that the REIT must declare to qualify for tax exemption. Candidates knew this and performed reasonably well in the computation.

Part (b)(iii) proceeded to test candidates on the tax treatment of the REIT distributions in the hands of the unit-holders. This was well done.

Question Four

This 20-mark question consisted of three separate elements. Candidates struggled in their responses to all parts of this question.

Part (a) required an explanation of the Real Property Gains Tax (RPGT) treatment of Timothy and his daughter Joanna in a series of transactions. Candidates did not deal securely with the issues of inheritance, gifts, and compensation received, although the disposal to a third party was well done.

Part (b) dealt with tax administration aspects of failure to submit tax returns, estimated assessments, time bars, appeals, and the ability to carry forward losses.

Part (c) for 4 marks pertained to goods and services tax.