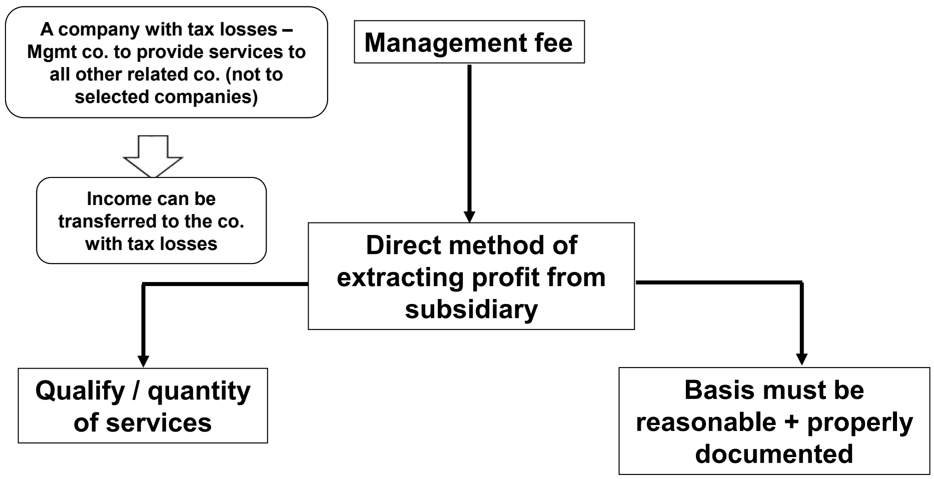
Tax Planning

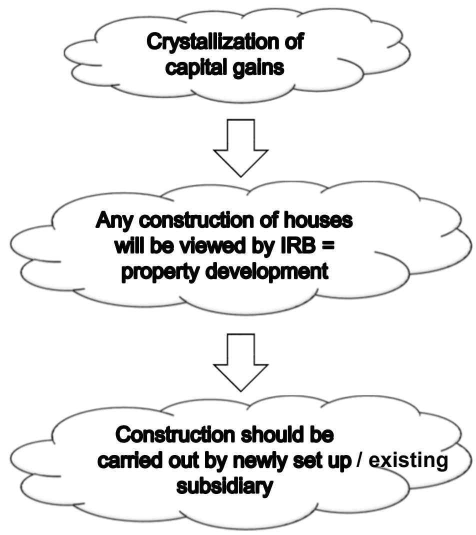


Management fee

- **Must be a precise basis for the quantum of management fee. Basis must be consistent year to year.**
- **HC must possess the expertise i.r.o. services rendered.**
- **Management fee must be reasonable and not excessive.**
- **Management fee must be charged to all subsidiaries in consideration of the services rendered. If certain subsi are not charged management fees although services are rendered, it may be argued that the management fees charged to other subsi are not at arm's length and are arbitrary charged.**
- **Should not be used as a disguise to transfer profit from "profit" making subsidiary to a loss making co. etc.**

Eg 42.2-42.3 pg 484-485

Tax planning – Principles to follow



Tax planning - Exercise 1

Voon Foong (Malaysia) Sdn Bhd has 1,000 acres of durian estate purchased 6 years ago for RM800,000. The company intends to develop the durian estate into time sharing residential units for sale. The construction would take 3 years and the estimated construction cost RM1.2 million. The expected sale from all the residential units is RM15.0 million. The durian estate was valued by Kam Weng Realty Sdn Bhd, at RM4.8 million as 31.12.2007.

<u>Answer:</u>

		RM'000
Sale of all residential units		**15,000**
Less: Land cost	**800**	
Construction cost	**1,200**	**(2,000)**
Chargeable income		**13,000**
Income tax payable @ 24%		**3,120**

Tax planning - Exercise 1 (Cont'd)

Using the above example, the durian estate company disposed the land to a subsidiary at the current market value, which is RM4.8 million.

Answer:

The gain would be subject to real property gains tax at RM200,000

	RM'000
Sale of land	
Disposal price	4,800
Less: Acquisition price	(800)
Chargeable gain	4,000
Real property gains tax @10%	400

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Tax planning - Exercise 1 (Cont'd)

The subsidiary incurred construction cost of RM1.2 million and disposed all the residential units. Income tax would be levied on the gain as the subsidiary carried on property development business.

	RM	RM
Sale		15,000
Less: Land cost	4,800	
Construction	1,200	(6,000)
Chargeable income		9,000
Income tax payable @ 24%		2,160

Compared to the above Example, the tax saving is RM560(14%x(4,800-800)

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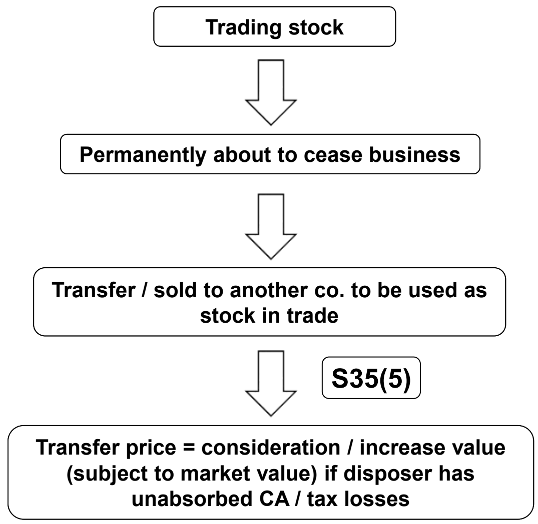
Tax Planning (cont'd)



Tax planning - Exercise 2

Ranjit Singh manufactures of shoes. On 14.2.2007, Ranjit Singh decides to discontinue his manufacturing business. The trading stock is valued at market value of RM2.8 million, although the cost is only RM1.8 million.

Ranjit Singh dispose of the stock to Siew Chuan (a relative) who is also carrying on manufacturing of shoes. Siew Chuan used the transferred stock in her manufacturing business.

Answer:

To defer payment of tax, Ranjit would then dispose of the stock at RM1.8 million to avoid income tax on 'profit' of RM1 million. When Siew Chuan subsequently sells the stocks for market value of RM2.8 million, income tax will then be assessed on her.

Section 35(5) permits a deferment of tax. The income tax on RM1.0 million may be avoided by Ranjit but would be imposed on Siew Chuan when she disposes of the stock.

Tax planning - Exercise 3

A company about to cease its business operation permanently. The details of the Company are as follows as at YA 2007:

		RM
a)	Trading stock	350,000
	- (Balance sheet as at 31.12.2007)	
	- Market value	400,000
b)	Unabsorbed RA	52,000
	Unabsorbed losses	23,000
	Unabsorbed CA	30,000
	Current year adjusted loss for YA 2007	30,000

Question:
How can you make full use of S35(5) of the ITA 1967 to utilise all the unabsorbed balances?

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Tax planning - Exercise 3 (Cont'd)

Answer:

Before liquidation, the trading stock should be sold for a cash consideration of RM485,000 arrived as follows:

	RM
Unabsorbed CA	30,000
Current year losses	30,000
Unabsorbed RA	52,000
Unabsorbed losses	23,000
	135,000
Add: Cost of trading stock	350,000
	485,000

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Tax planning - Exercise 3 (Cont'd)

<u>Answer:</u>

	RM
Profit on sale of trading stock	
(RM485,000 – RM350,000)	135,000
Adjusted loss	(30,000)
Revised result-adjusted income	105,000
Deduct: Unabsorbed CA	(30,000)
Statutory income	75,000
Unabsorbed RA	(52,000)
Statutory income	23,000
Less: Unabsorbed losses	(23,000)
Chargeable income	Nil

Single or separate businesses

- Important as utilisation of CA cannot be set off against income from another business source
- Depend entirely on the nature and interdependence of such activities
- Case law: *' if one or two activities cannot be stopped without affecting the framework of the other ->same business'*

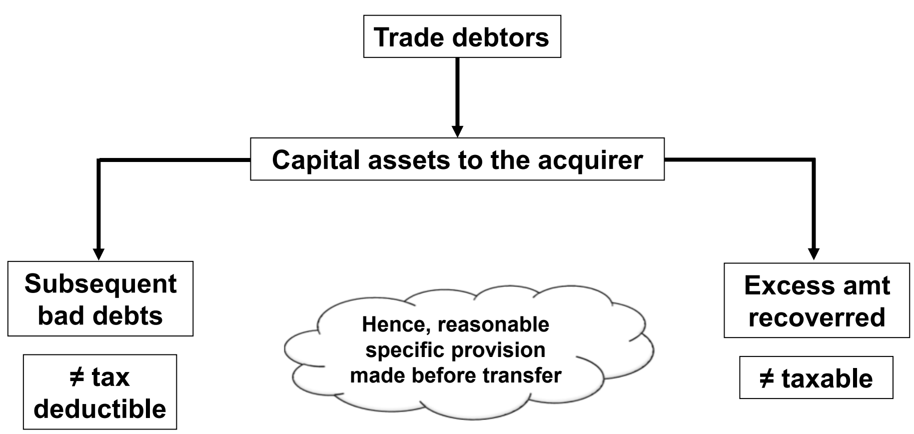
Single or separate business

Whether sharing the same characteristics of the following:

- Core ingredient of the existing business
- Overall control and management
- Manufacturing processes is entirely/almost the same?
- Using the same equipment and expertise?

Eg 39.3, 39.4 pg 425

Tax planning (cont'd)



Eg 42.5,pg487

Tax planning (cont'd)

- **Current year biz loss**
  = allowed against all sources of income
  = can surrender ≤ 70% to related company (if conditions fulfilled)

- **Unabsorbed biz loss (carried forward up to 10 YAs after its incurrence)**
  = can only be used to set off against the aggregate statutory business income
  = unabsorbed tax losses cannot be transferred, hence investor should buy up the equity of the co. with tax losses and then introduce profit-making business into the tax-loss co.
  = must have commercial reasons to do so (take note of Section 140 anti avoidance)

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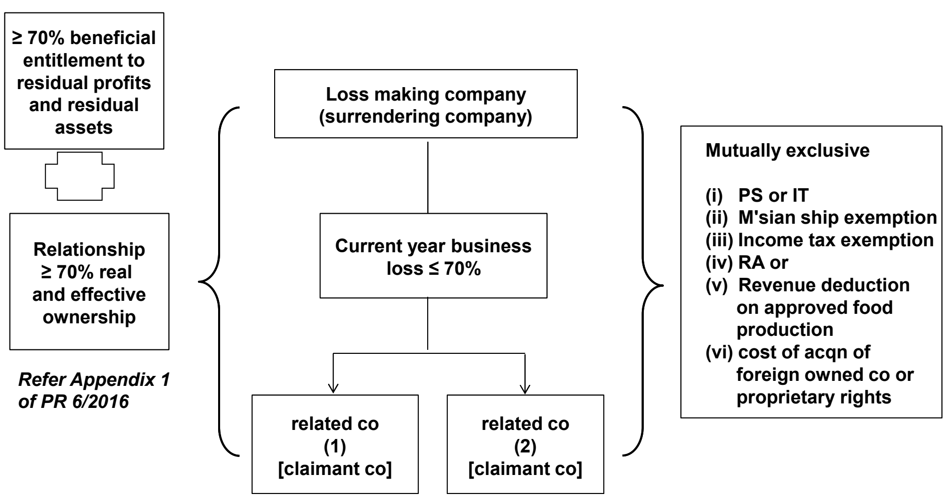
GROUP RELIEF



WEF YA2019,claimant co that has unabsorbed ITA & current year loss from pioneer biz under PIA is restricted to participate in group relief.

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GROUP RELIEF (Cont'd)

Conditions(for surrendering & claimant companies):
(1)Tax resident + incorporated in M'sia *(including the medium companies wef YA2022)*

(2) Related co throughout that yr + 12 month period prior to that YA
(surrendering co must have commenced business for a period of 12 months)

(3) PUC > RM2.5 million

(4)Common 12 mth period ending on the same day

(5) Make an irrevocable election to surrender or claim the biz loss in their respective tax return

(6) Subject to income tax at 24%

(7) Claimant co has defined aggregate income (DAI) for that YA.
Does not permit the claimant Co. to claim the biz loss > its DAI

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GROUP RELIEF (Cont'd)

- **WEF YA2019** ,the transfer of adjusted losses to a related company only applies to surrendering company which first commences its operation (i.e. start-up company).

- Surrendering of adjusted losses by the surrendering company is restricted to 3 consecutive YAs, whether or not any adjusted losses are surrendered:
  (i) It commences immediately following the YA which consists of a basis period of 12 months the company first commences operation.

  (ii) If the basis period for a YA the surrendering company first commences operation is less or more than 12 months, the surrendering company is allowed to commence surrendering its adjusted losses immediately after the second basis period for the YA the surrendering company first commences operation and the second basis period consists of a period of 12 months.

Note: A claimant company must first fully utilize its unutilized ITA or unabsorbed pioneer losses before being able to receive business losses surrendered from its related company

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GROUP RELIEF (Cont'd)

<u>Defined aggregate income</u>

Aggregate income

-S44(1)	(a)	Current year loss	XX
	(b)	Prospecting expenditure / pre-operating biz expenditure	(X)
	(c)	Donations	(X)
	(d)	Other donations	(X)
Defined Aggregate Income			XX

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GROUP RELIEF (Cont'd)

<u>Penalty</u>

- incorrect information on adjusted loss surrendered
- adjustment on claimant Co.
- penalty imposed on surrendering Co.

  = amount of tax undercharged by claimant Co.

Eg 40.2 pg460,40.4 pg 464

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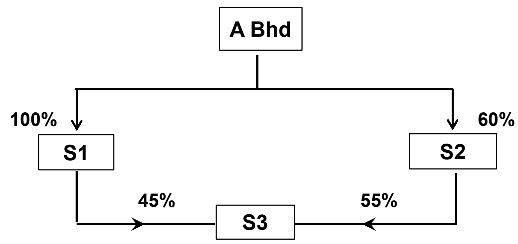
GROUP RELIEF (Cont'd)

Example 1:



% of holding

(i) A Bhd & S1 100%
(ii) A Bhd& S3 (100% x 45%) + (60% x 55%) = 78%
(iii) S1 & S3 S1 & S3 are ≥ 70% commonly controlled by A Bhd

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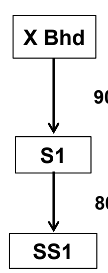
GROUP RELIEF (Cont'd)

Example 2:



Refer Eg 1 to 7 of PR 6/2016

% of holding

(i) X Bhd & SS1 90% x 80% = 72%

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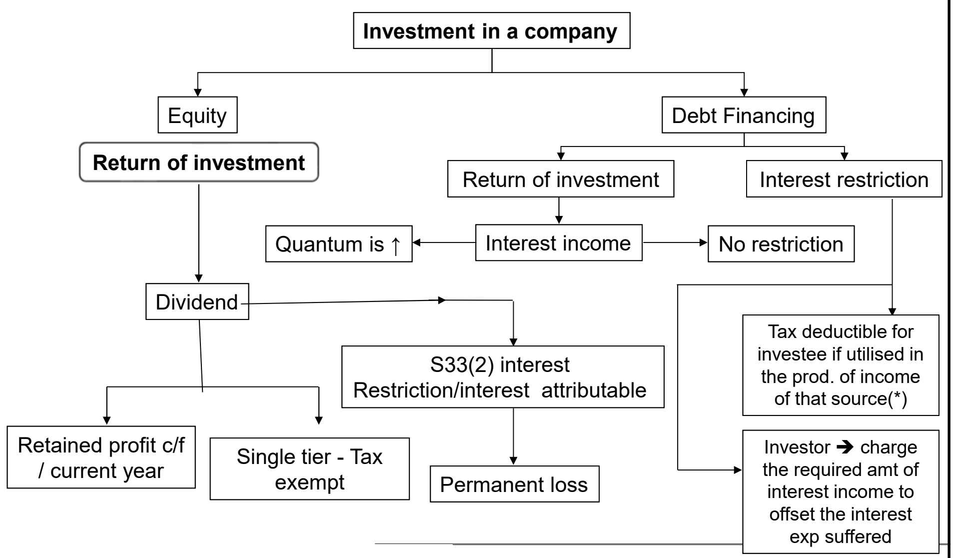
Tax planning (cont'd)



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Interest expense – tax deductible(*)

Section 33 (1)(a):

- **Governing specifically on interest expenses on money borrowed (loan) as deduction.**
- **Deductibility of interest expense under S 33(1)(a) must satisfy only 2 conditions:**
  - **a. A sum of money must have been borrowed; and**
  - **b. The borrowed money must have been either;**
    - **i. Employed in the production of gross income from that source (working capital); or**
    - **ii. Laid out on assets used/held in that period for the production of gross income from that source**

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Tax planning (cont'd)

To ensure interest expense qualify for deduction:

- **Building generate rental income**
- **Advances generate interest income***
- **Identification of investments / advances funded from existing borrowings & direct allocation of the cost of borrowings to the investment / advances**
- **Review interest charges annually; source for cheaper financing.**

* To charge mkt rate of interest to avoid any transfer pricing attack from IRB and to recoup its own interest expense against the interest income received

Tax planning (cont'd)

To ensure interest expense qualify for deduction: (cont'd)

- **Arrange the subs/asso to borrow directly from bank**
- **Establish separate bank a/cs to hold specific loan monies exclusively for business use.**
- **Disposal of investment not profitable to pay off the borrowings with high cost of fund**
- **Withdrawal of FD to pay off the borrowings**

Advantages of SME

- Lower income tax rate of 17% (instead of 24%)on the first RM600,000 of its CI
- Can claim CA on small value assets and not limited to RM20,000 per YA
- Exempted to file tax estimate for first two YAs

SME= incorporated in Msia;+
= Tax resident in Msia;+
= PUC at the beginning <= 2.5million;+
= Gross income from business<= RM50 million;+
=NO related companies having PUC > 2.5.million

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Tax planning (cont'd)

Distinction

Business income

- Availability of CA
- Availability of current yr loss
- Carry forward unabsorbed loss
- Biz income can be offsetted against unabsorbed biz loss even though different sources

Investment income

- Deductibility of expenses = wholly & exclusively test
- Excess = permanent loss
- Current year loss ≠ offset against other income

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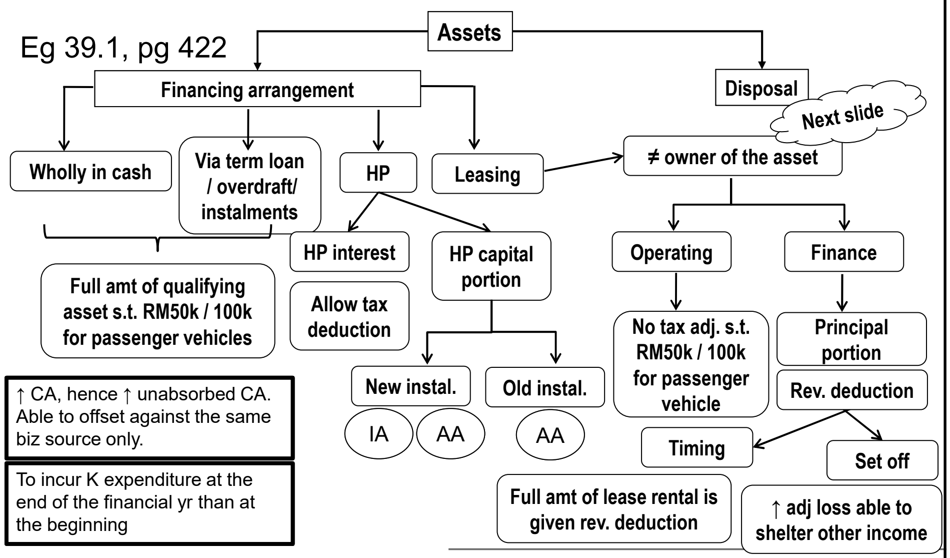
Tax planning (cont'd)



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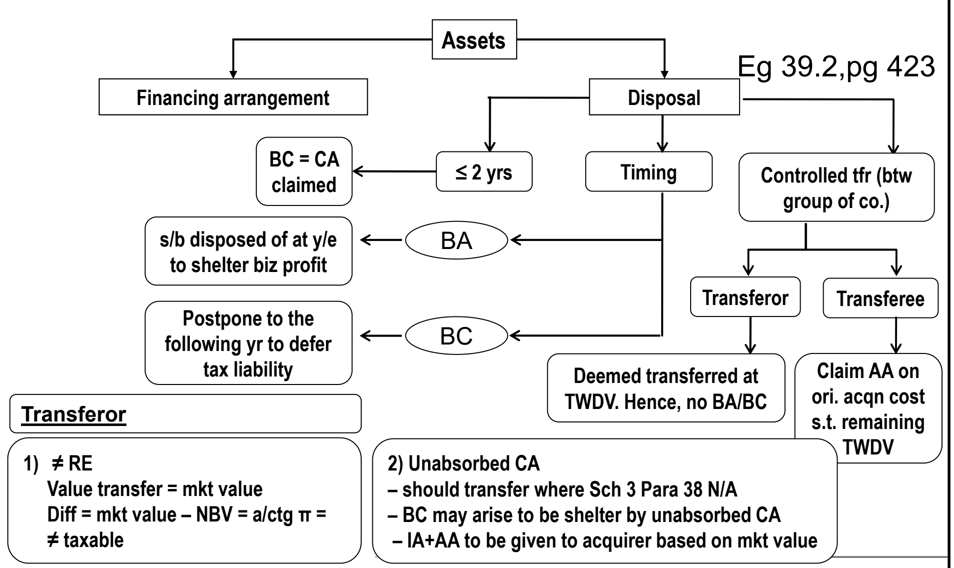
Tax planning (cont'd)



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