
Answers

Marks

- 1 (a) Report to The directors of Salmon Berhad
From Tip Top Tax Services Sdn Bhd
Date 3 December 2007

Tax estimate for the year of assessment 2008

In response to your request and based on the information provided by yourselves, we have pleasure in reporting to you as follows:

- (i) Estimated tax payable

We have prepared an estimate of the amount of income tax payable by Salmon Berhad for the year of assessment 2008. The amount is RM59,940 as per the computation in the attached appendix.

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- (ii) Time for submission of an estimate and the penalty for late submission

Salmon Berhad is required by law to submit an estimate of tax payable for the year of assessment 2008 no later than 1 December 2007. Having missed the deadline, the company has committed an offence and is liable to a penalty, which on conviction, may be not less than RM200 and not more than RM2,000. However, the offence can be compounded by the Director General of Inland Revenue.

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- (iii) Tax deduction for management and administration expenses

It appears that all these expenses are able to qualify for deduction as none of the expenses incurred are specifically disallowable and assuming that the audit fee is in respect of the statutory audit [Income Tax (Deduction for Audit Expenditure) Rules 2006].

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Salmon Berhad is a listed investment holding company and as such, the company's income is deemed to be business income and deductible expenses are allocated to the respective sources of income *pro rata* to gross income. The sources of income have been taken to be dividends and interest respectively. The management and administration expenses have been allocated between them in proportion to the gross income sums.

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Salmon Berhad is a listed investment holding company because (a) its activities consist mainly in the holding of investments; (b) not less than 80% of its gross income consists of income from investments; (c) it is resident in Malaysia; and (d) it is listed on Bursa Malaysia.

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- (iv) Deduction for interest expense

The interest expense is wholly and exclusively incurred in relation to the dividends and interest derived from the shares and loan to Mackerel Sdn Bhd. As the loan of RM2.5 million is a separate and specific one taken out for the purposes of making the investment in Mackerel Sdn Bhd, the interest on it is deductible only against the dividend and interest income received from Mackerel Sdn Bhd.

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(v) Appendix

Computation – estimated tax payable for the year of assessment 2008

	RM	RM	
Dividend income:			
Dividend from Mackerel Sdn Bhd RM219,000 x 100/73	300,000		1/2
Less: Interest expense RM150,000 x 1/2·5	(60,000)		1/2
Management and administration expenses RM128,000 x 300,000/800,000	<u>(48,000)</u>		1/2
Statutory income:		192,000	
Interest income:			
Interest on debentures and bonds	410,000		1/2
Interest from Mackerel Sdn Bhd	90,000		1/2
	<u>500,000</u>		
Less: Interest expense RM150,000 x 1·5/2·5	(90,000)		1/2
Management and administration expenses RM128,000 x 500,000/800,000	<u>(80,000)</u>		1/2
Statutory income:		<u>330,000</u>	
Chargeable income		522,000	1/2*
Tax chargeable at 27%		140,940	1/2
Dividend tax credit RM300,000 at 27%		<u>(81,000)</u>	1/2
Tax payable		<u>59,940</u>	<u>5</u>

* The 1/2 mark is awarded for the correct description.

Appropriate format, style and presentation of the report
Effectiveness and communication

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(b) Tip Top Tax Services Sdn Bhd

12-14 Tingkat 36
Menara Tinggi
Petaling Jaya
Selangor

The Secretary
Salmon Berhad
Wisma Salmon
Jalan Pasar Borong
Kuala Lumpur

3 December 2007

Dear Sir,

Proposed management fees system

We have considered the proposal outlined by you and present our advice on the income tax implications:

(i) Income tax implications for Salmon Berhad

When Salmon Berhad receives management fees from its subsidiary companies, that will constitute a source of business income for Salmon Berhad and the income will be taxable. However, expenses wholly and exclusively incurred in earning these fees can be deducted. No doubt this will include a proportion, or maybe the whole, of the management and administration expenses which are already being incurred but, without further information, it is difficult to say what that proportion would be. To the extent that any assets which attract capital allowances are used for the purposes of the new activity, the relevant capital allowances can be deducted from the adjusted income.

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The creation of a new non-investment source of income could affect the company's status as an investment holding company. That would come about if the management fees amounted to more than RM200,000 which would mean that less than 80% of the gross income would be derived from investments. However, the company will continue to be an investment holding company until it proves otherwise. One immediate impact of a change of status would be that the management and administration expenses would cease to be deductible from investment income sources. That might be detrimental if less than the whole of such expenses were deductible against income from the new business source.

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(ii) Income tax implication for the subsidiary companies

The main consideration here is whether, and to what extent, the management fees would be allowed as a tax deduction. Disallowance is likely unless the fees are at a reasonable level comparable with an arms length rate and applied consistently under a properly formulated agreement. The level of the management fees should be determined having regard to the extent and nature of the services actually provided to the subsidiary companies. In each case the services should be relevant to the ordinary business activities of the subsidiary concerned.

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Mackerel Sdn Bhd is profitable and would obtain effective tax relief from the deduction of management fees. Tuna Sdn Bhd is incurring losses and would obtain no immediate relief, however, the fees would augment any loss incurred and effective relief is only deferred. Sardine Sdn Bhd would receive no benefit from the charging of management fees because it is enjoying a 100% tax exemption. From a group point of view, the tax effectiveness of this proposal is therefore limited.

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Please do not hesitate to let us know if you need any further explanations or advice.

Yours faithfully

A.B.Singh

Director

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Appropriate format, style and presentation of the letter
Effectiveness and communication

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2 (a) (i) The gifting of a half-share of the rented condominium to Alex will be tax-efficient so far as income tax is concerned because it will result in two incomes rather than one. There is an annual tax saving of RM4,425 (see working) because each partner is entitled to a personal allowance and reduced rates. Alex's pension is from a foreign source and, as such, it is not liable to tax in Malaysia.

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Although there is still an overall saving of income tax, this is impaired by the loss of tax relief on half of the loan. On taking out the new loan with the bank, Kate's half-share of the interest will still qualify for a tax deduction because it is a replacement loan for the one she took out to acquire her interest in the property. However, Alex's half-share of the loan interest does not qualify for any relief because the new loan was not used by him to acquire any asset.

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On the transfer of a half-share of the condominium to Alex, stamp duty of RM12,000 will be payable on the market value of the half-share (see working).

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It appears that the proposal is not tax efficient overall because it will take nearly three years for the income tax savings to cover the stamp duty to be incurred on the transfer. This is without taking into account other costs such as legal fees, mortgage costs and registration charges.

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(ii) Workings

Income tax

	Kate as single owner RM	Kate as joint owner RM	Alex as joint owner RM	
Net rental income before loan interest (RM8,000 + RM3,000 = RM11,000 x 12)	132,000	66,000	66,000	1½
Loan interest (RM3,000 per month)	(36,000)	(18,000)	–	1
	<u>96,000</u>	<u>48,000</u>	<u>66,000</u>	
Personal allowance	(8,000)	(8,000)	(8,000)	1
Husband allowance	(3,000)	–	–	
Chargeable income	<u>85,000</u>	<u>40,000</u>	<u>58,000</u>	
Tax on RM70,000	7,275			
Tax on RM18,000 at 24%	3,600			
Tax on RM35,000		1,525		
Tax on RM5,000 at 13%		650		
Tax on RM50,000			3,475	
Tax on RM8,000 at 19%			1,520	
	<u>10,875</u>	<u>2,175</u>	<u>4,995</u>	1½

Annual tax saving = RM3,705 (RM10,875 – RM2,175 – RM4,995)

Stamp duty

	RM	
Market value of half share	1,000,000	
Duty on the first RM100,000 at 1%	1,000	
Duty on the next RM400,000 at 2%	8,000	
Duty on the next RM500,000 at 3%	15,000	
	<u>24,000</u>	
Less: 50% remission [Stamp Duty (Remission) (No 7) Order 2002]	12,000	
	<u>12,000</u>	2
		<u>7</u>

- (b) Kate's sale of the bungalow will not attract any liability to real property gains tax if the exemption applicable to disposals made from 1 April 2007 onwards continues to apply.

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However, Kate may be treated as carrying on an adventure in the nature of trade. Although not necessarily conclusive, the following factors tend to indicate such an adventure

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- The holding period of the asset is short.
- Kate has a history of buying and selling property.
- She has experience of renovating properties.
- She has borrowed short term and appears to have no plan to repay the borrowing.
- Although she stated her intention as wanting to occupy the property, she sold it without any obvious reason for her change of mind.

each
= max
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In the event that Kate is treated as having carried on an adventure in the nature of trade, the sale proceeds and all costs of extension and renovation, as well as incidental costs of acquisition and disposal, will be taken into account. She will also be able to bring in as an expense the interest incurred on the bank loan during the period of extension and renovation of the property. In addition she will probably be able to claim a deduction for expenses incurred by her when carrying out her business activity, such as travelling and telephone costs. The profit will be charged to income tax in Kate's name in the year of assessment in the basis period for which the property is sold.

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- (c) (i) One immediate tax implication arising from the occupation of a property belonging to the company is that if Kate and Alex are directors of the company, they will be treated as having received a benefit in kind to the extent of the annual value of the property. As the property is owned, this is likely to be based on the rateable value. It appears that the company will have no income so there is no tax implication for the company.

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	Marks
(ii) When the company disposes of the bungalow, it is quite likely that it will be treated as carrying on an adventure in the nature of trade. The reasons are:	1
– A company is presumed to come into existence for the purposes of carrying on a business.	1
– The holding period of the asset is short.	each
– The asset has never produced income.	=
– The company borrowed short term and appears to have no plan to repay the borrowing.	max 3
 The profit to the company will be calculated in a similar way to that of Kate but there are other implications. If Kate and Alex wish to extract funds from the company, they have the choice of:	 1
– A dividend which can presumably be franked by the tax payable on the profit realised by the company.	1
– Loan repayment if part of the finance provided by Kate and Alex is made available by way of loans.	each
– Distribution of assets on liquidation of the company.	=
	max 2
	<u>7</u>
 3 The following tax incentives are available in Malaysia:	
(a) MSC status incentives	
Multimedia Super Corridor (MSC) status is awarded to companies undertaking information and communication technology and multimedia activities, including call centres, in the Designated MSC Cybercities and the Designated MSC Cybercentres (see below) subject to approval by the Multimedia Development Corporation.	2
MSC status will enable the company to enjoy the following tax incentives:	
(i) Either:	
– Pioneer status with 100% income tax exemption on statutory income for ten years;	2
(ii) Or:	
– Investment tax allowance. This is based on 100% of qualifying capital expenditure incurred for five years, including the cost of acquiring multimedia and peripheral equipment, the purchase, construction or renovation of a building, plant and machinery and landscaping and greening. It can be offset 100% against statutory income.	3
An MSC status company can also enjoy exemption from deduction of withholding tax on payments made to non-residents for technical advice and services, and licensing fees and interest on loans for technology development.	1
Selected companies undertaking information and communications technology and multimedia activities outside the Cybercities, which are recommended by the Multimedia Development Corporation will be able to qualify for incentives for five years consisting of pioneer status with 50% tax exemption or investment tax allowance at 50% to be offset against 100% of statutory income. Companies enjoying this incentive are allowed to carry forward their unabsorbed losses and capital allowances to set off against their post-pioneer income from the same activity.	3
The Designated MSC Cybercities are Cyberjaya, Technology Park Malaysia, Universiti Putra Malaysia-Malaysia Technology Development Corporation (UPM-MTDC), Kuala Lumpur City Centre, Kuala Lumpur Tower, Penang Cybercity 1 and Kulim High Tech Park. The Designated MSC Cybercentres are Kuala Lumpur Sentral and the Melaka International Trade Centre.	1
(b) Industrial buildings allowance	
The owner of a new and not previously occupied building located in Cyberjaya is entitled to an annual allowance at 10% per annum based on qualifying capital expenditure incurred by him. It is given for ten years. This applies to the owner of a building occupied by an MSC status company, whether the owner is the MSC status company itself or another owner renting it to the MSC status company.	2
(c) Training of employees	
A tax deduction can be given for the cost of training potential employees to impart basic skills when undertaken within one year prior to the commencement of business, unless training grants are received from the government. The deduction is given on commencement of business.	1
(d) Duty free imports	
An MSC company is allowed to import multimedia equipment duty free.	1
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4 (a) Tax residence

In view of the fact that Suhaimi has only made a few short visits to Malaysia during the last few years, the possibility that he has become or remained a Malaysian resident in any year can be ignored. In that case, the only factor affecting Suhaimi's tax residence status in 2007 is whether the period of one week, which he intends to spend in Malaysia in 2007 will be linked by or to a continuous period of 182 days or more during which he will be present in Malaysia in 2008.

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As the continuous period should not be broken, except for certain permitted absences, it will not be possible to determine this for certain until some time during 2008. The permitted absences are those:

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- connected with Suhaimi's service in Malaysia owing to service matters or attending conferences or seminars or study abroad;
- owing to ill-health involving himself or a member of his immediate family; and
- social visits not exceeding fourteen days in aggregate.

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Even if the permitted absences are not exceeded during 2008, there is still the problem of linkage with the one week period in Malaysia during 2007. The gap between that period and the date of Suhaimi's arrival in Malaysia in 2008 must also be bridged by a period of permitted absence as mentioned above. The only absence likely to count at that time is for social visits and there would be no linkage if those days exceeded fourteen. The maximum gap that could be achieved is that caused by Suhaimi leaving Malaysia on 17 December 2007 and returning on 1 January 2008. However, that would exhaust all of the days allowed for social visits in 2008.

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(b) Effect of a change of residence status

As Suhaimi and Rohaya are being taxed as non-residents, their rental income attracts tax at the rate of 28% with no personal allowances. If Suhaimi were to become a tax resident for the year of assessment 2007, his own share of the rental income for the whole year would be taxed on a resident basis. Suhaimi's half share of the rental income would then attract no tax at all because it is fully covered by the personal allowance of RM8,000 and the nil tax band of RM2,500. Rohaya would still be a non-resident and, if Suhaimi were assessed to tax separately, her half share of the income would still be taxed at 28%.

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However, Rohaya is allowed to elect for joint assessment with Suhaimi even though she is a non-resident in view of the fact that she is a Malaysian citizen. If she were to do that, the whole of the net rental income of RM21,000 would become Suhaimi's income for tax purposes. There would still be no tax to pay as Suhaimi would then be able to claim a wife relief of RM3,000. Any small amount of tax payable would be covered by the small income rebate of up to RM700.

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(c) Foreign salary and bonus

Foreign source income not remitted to Malaysia is not within the charge to tax. When it is remitted to Malaysia it is exempt so there will be no tax to pay on Suhaimi's salary and bonus because the source of income is his employment outside Malaysia.

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5 (a) C.Y.Lee and his wife

C.Y.Lee and his wife have admitted to making false entries in their books of account and records and it appears that they are equally guilty. This is presumed to be wilful evasion of tax unless they can prove to the contrary (section 114). The penalty on conviction is a fine of RM1,000 up to RM20,000 or imprisonment for up to three years, or both, with a special penalty of up to three times the amount of tax undercharged.

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However, the matter might be dealt with as the offence of submitting incorrect returns (section 113). In that case, the Director General has power to compound the offence, if there is no conviction. The compound can be up to the amount of tax charged but it is likely to be much less. (The maximum indicated by the Inland Revenue Board Guide on Tax Audit is 100%.) Otherwise, if there is a conviction under that section, a fine of RM1,000 up to RM10,000, and a special penalty of up to double the amount of tax undercharged can be imposed.

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(b) Alvin Ng

Alvin Ng has assisted C.Y.Lee and his wife in the preparation of their tax returns and this has resulted in an understatement of their tax liabilities. Unless he can satisfy the court that he has taken reasonable care, he can be found guilty of an offence (section 114(1A)). On conviction, he can be fined from RM2,000 up to RM20,000 or imprisoned for up to three years, or both, in respect of each offence.

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Reasonable care is the degree of care or conscientiousness in paying proper attention to a task that is expected, in a similar situation, of any ordinary person who, considering the circumstances and the foreseeable consequences, acts with reason, sound judgment and responsibility (Inland Revenue Board Public Ruling No. 8/2000 Wilful Evasion of Tax and Related Offences). On being told by his wife that she had been informed of the double set of books, Alvin Ng could have put the matter to C.Y.Lee and his wife to see whether they were able to offer an explanation but he chose to do nothing. His inactivity in the circumstances, points to a lack of reasonable care.

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