Answers

Note: All references to legislation or public rulings shown in square brackets are for information only and do not form part of the answer expected from candidates.

1 (a) The two most significant reasons why a taxpayer would prefer to treat rent from letting property as business income rather than as income falling under section 4(d) are:

The availability of loss relief.
Business income is dealt with by section 4(a), under which a deficit of income (an adjusted loss) may be relieved by way of set off against the aggregate of other sources of income of the taxpayer for the same year of assessment.

An adjusted loss from a business of letting, or part thereof, not relieved in the current year may be carried forward to be set off against business income from any source, or sources, arising in future.

A surplus of adjusted income from a business of letting can also be used to relieve a loss from another business of the taxpayer sustained in earlier years.

The availability of capital allowances.
Capital allowances based on qualifying capital expenditure are available for a business source. The allowances may be relieved against adjusted income of the same business source for the year of claim or, in the event of a shortage of adjusted income, against adjusted income of the same business for future years.

None of these set offs or allowances are available under section 4(d).

(b) (i) Peacock Sdn Bhd does not qualify for reinvestment allowance for the year of assessment 2006 because the capital expenditure in that year was incurred within twelve (12) months after commencing operations. However, Peacock Sdn Bhd does qualify for reinvestment allowance for the year of assessment 2007 because in that year it incurred capital expenditure on plant and machinery for the purpose of automating its existing business more than twelve (12) months after commencing operations.

(ii) The qualifying period commences with the basis period for the year of assessment 2007, i.e. the first qualifying year, that is from 1 December 2006.

The qualifying period ends with the basis period for the year of assessment 2021, i.e. fifteen (15) years later, which will be 30 November 2021 if the company keeps the same basis period.

(iii) A company can qualify for a 100% set off against statutory income:

– if the qualifying project is located in a promoted area, that is to say Sabah, Sarawak, Labuan Federal Territory, Perlis or the Eastern Corridor of Peninsular Malaysia (Kelantan, Terrenganu, Pahang and Mersing in Johor), or
– if it has achieved the prescribed level of productivity (the PE ratio).

(c)

Messrs Slick and Easy
Unit 18A-4-2
Merdeka Plaza
Penang

The Secretary
Jupiter Berhad
15 Jalan Syabas
Industrial Estate
Seberang Prai

2 June 2008

Dear Sir,

Income tax for the year of assessment 2007 and 2008

We have pleasure in presenting our report on the income tax situation of the company as specified in your letter of instruction.

(i) Control transfer implications for capital allowance purposes

The acquisition of the borer and grinder are both a control transfer as the degree of control of Venus Sdn Bhd and Mercury Sdn Bhd is more than 50% in each case. The actual price at which the assets were transferred is therefore ignored and no balancing adjustment is made. However, the original acquisition of the borer took place during the disposer's final period (the year to 31 March 2007) so no capital allowances were, or could have been, claimed by Venus Sdn Bhd. Consequently, Jupiter Berhad is entitled to claim both the initial and annual allowances based on Venus Sdn Bhd's actual acquisition price.

(ii) Capital allowances

The qualifying capital expenditure incurred by the company will entitle it to capital allowances of RM222,460 for the year of assessment 2007 and RM193,060 for the year of assessment 2008. However, as the company has an adjusted loss for the year ended 31 March 2007 the allowances for the year of assessment 2007 must be carried forward, resulting in a total of RM415,520 in capital allowances being available for utilisation in the year of assessment 2008.

Details of the calculation of these allowances are contained in the appendix to this letter at Schedule 1.

(iii) Control transfer implications for reinvestment allowance purposes

The control transfer provisions also apply for reinvestment allowance purposes. The deemed acquisition price for the grinder is therefore the residual expenditure of Mercury Sdn Bhd, however, as for capital allowances above, the borer which was acquired by the disposer Venus Sdn Bhd during its final period will be treated as acquired at Venus Sdn Bhd's actual acquisition price. [Paragraph 1B(1) and (2) Schedule 7A.]

(iv) Reinvestment allowance

The qualifying capital expenditure incurred by the company will entitle it to a reinvestment allowance of RM132,552 for the year of assessment 2007, in addition to the unabsorbed reinvestment allowance brought forward from the year of assessment 2006 of RM84,000. As in the case of capital allowances (above) owing to there being an adjusted loss for the year ended 31 March 2007, these allowances must be carried forward to the year of assessment 2008, resulting in a total of RM216,552 in unabsorbed reinvestment allowance being available for utilisation in that year.

Details of the calculation of these allowances are contained in the appendix to this letter at Schedule 2.

(v) Chargeable income

The chargeable income for the year of assessment 2008 is NIL, owing to the adjusted loss carried forward from the year of assessment 2007 and the capital allowances and reinvestment allowance available for utilisation (as detailed above). Further, there remains an unabsorbed loss of RM376,656 and unabsorbed reinvestment allowance of RM115,416 available for carry forward to the year of assessment 2009.

Details of the calculation of the chargeable income for the year of assessment 2008 are contained in the appendix to this letter at Schedule 3.

We would be happy to provide any further explanations and advice that you may need.

Yours faithfully

Slick and Easy

Appendix

Schedule 1: Capital allowances years of assessment 2007 and 2008

	RM	RM
Year of assessment 2007		
Previous years' qualifying plant expenditure		1,120,000
Current year's qualifying plant expenditure for annual allowances:		
Borer	147,000	
Grinder	112,000	259,000
		1,379,000
Initial allowance RM147,000 x 20%		29,400
Annual allowance RM1,379,000 x 14%		193,060
Unabsorbed capital allowances carried forward		222,460
Year of assessment 2008		
Annual allowance RM1,379,000 x 14%		193,060
Unabsorbed capital allowances brought forward		222,460
Allowances fully utilised for YA 2008		415,520

Schedule 2: Reinvestment allowances years of assesment 2007 and 2008

	RM
Year of assessment 2007	
Qualifying expenditure – basis period to 31 March 2007	
borer	147,000
grinder (residual expenditure – see working)	73,920
	220,920
Reinvestment allowance for YA 2007 – 60% x RM220,920	132,552
Unabsorbed reinvestment allowance brought forward	84,000
Unabsorbed reinvestment allowance carried forward	216,552
Year of assessment 2008	
Unabsorbed reinvestment allowance brought forward	216,552
Allowances utilised for YA 2008 as per (v) below	101,136
Unabsorbed reinvestment allowance carried forward	115,416

Note: Residual expenditure for grinder

	RM	RM
Qualifying expenditure to Mercury Sdn Bhd		112,000
Initial allowances 20% – YA2006	22,400	
Annual allowance 14% – YA2006	15,680	38,080
		73,920

Schedule 3: Chargeable income years of assessment 2007 and 2008

	RM
Year of assessment 2007	
Chargeable income	Nil
Unabsorbed adjusted loss carried forward	420,000
Year of assessment 2008	
Adjusted income	560,000
Capital allowances	415,520
Statutory income	144,480
Reinvestment allowances RM216,552 limited to 70% of RM144,480	101,136
Aggregate statutory income	43,344
Unabsorbed losses brought forward RM420,000 limited to	43,344
Chargeable income	Nil
Unabsorbed adjusted loss carried forward RM420,000 – RM43,344	376,656

2 (a) **Report to** **En Johari, En Khairul and Cik Lisa**
From **The business accountant**
Date **2 June 2008**

Proposed transfer of business to Newco Sdn Bhd – tax implications

In response to your request, I present my report on the assets mentioned below.

(i) Trading stocks

As the trading stocks are to be used by Newco Sdn Bhd in its own business, the price paid to the partnership, whatever that may be, will be treated as income of the partnership and as the cost to Newco Sdn Bhd [s.35(5), ITA]. I recommend using the book value, which would be the lower of cost or market value, as the sale price. This avoids distortions.

If a higher value is used there may be an effect on tax liabilities by bringing profits forward. It is not likely to be advantageous because it would bring the tax payment date forward by several months and may result in tax being paid at a higher rate than that applicable to Newco Sdn Bhd. Using a value lower than cost or market value is likely to be looked upon as an attempt at tax avoidance, possibly resulting in action by the Inland Revenue to counter the effect of it.

(ii) Trade debtors

In general, debts should be transferred at their book values and there will be no tax implications if a debt is paid in full to Newco Sdn Bhd.

However, there will be no tax deduction for Newco Sdn Bhd if a debt should turn out to be bad after it is transferred to the company.

In the case of any doubtful debt, a realistic specific provision should be made against any anticipated loss in the final partnership accounts before the transfer. The debt can then be transferred to Newco Sdn Bhd at its net value after deducting the provision.

(iii) Short-life assets

Assets such as these are not treated as qualifying expenditure and they do not qualify for capital allowances. They are dealt with on the replacements basis which means that the initial purchase is not given a tax deduction but subsequent replacements are. In theory, the original stock of such items could be sold without any tax implications but because of difficulties in identification, any sale proceeds are likely to be taxable. In any case, the amount paid by Newco Sdn Bhd would not be given a tax deduction as it would be regarded as the first purchase by that company. In the circumstances, I recommend that these assets be transferred for no consideration. The cost of subsequent replacements could still be claimed for as a deduction.

(iv) Commercial vehicles

In spite of the fact that the partners are siblings, the transfer of the commercial vehicles does not qualify as a disposal subject to control as no single partner will have control of Newco Sdn Bhd. [para.38, Schedule 3, ITA.] Consequently, all of the assets on which capital allowances have been or could have been claimed, including those which have been fully written off, will have to be valued at the higher of the sale proceeds or their market value and balancing charges or balancing allowances computed accordingly. [Para. 62, Schedule 3, ITA.] Assets acquired by the partnership from the end of the previous basis period up to the date of transfer will not have qualified for any capital allowances. There can be a loss of relief if such assets are transferred to Newco Sdn Bhd at a price which is less than cost.

I recommend that the commercial vehicles be transferred to Newco Sdn Bhd at the following values:

Vehicles which have qualified for capital allowances	–	market value
Vehicles which have not qualified for capital allowances	–	cost

It should be possible for Newco Sdn Bhd to claim initial and annual allowances based on the transfer price in each case.

(v) Motor cars for the use of the partners

Motor cars for the use of the partners are eligible for capital allowances and similar considerations apply to those mentioned above for the commercial vehicles. However, there are some extra implications to be taken into account.

A private motor vehicle is eligible for capital allowances up to a total of RM100,000 if the vehicle is unused and the original cost does not exceed RM150,000 and up to RM50,000 if the original cost does exceed RM150,000. When balancing allowances or balancing charges have to be calculated, they will be based initially on the higher of the sale proceeds or market value. That figure will be scaled down by reference to the amount allowed as qualifying expenditure, RM50,000 or RM100,000 as the case may be, divided by the cost of the car.

I think it is best to transfer the private cars at market value as that value will have to be brought in to calculate balancing allowances and charges. There is no advantage in using a different value. The acquisition price to Newco Sdn Bhd, limited to RM50,000 in each case, will be eligible for initial and annual allowances.

For the partners themselves, there will be a difference in the way that the private use of cars is dealt with for tax purposes. As self-employed individuals, the calculated benefit of private use is presently included as part of their total income from the partnership. As directors of Newco Sdn Bhd they will be treated as employees and assessed to tax on a benefit in kind based on a prescribed value. This will usually give them a lower taxable benefit.

(vi) Freehold shop premises

The transfer of the freehold shop premises to Newco Sdn Bhd has no particular income tax implications. It is not an industrial building and no capital allowances are available.

The value at which this asset is transferred is not critical. However, market value is probably better because that would allow a larger part of the sale price of the assets to be left owing to the three individuals as a loan. This might be a useful way to extract surplus cash from the company in the future.

3 (a) (i) Factors that help to determine how much of the gross income arising from the sale of computer chips to United States customers is recognised are:

– Stadium Berhad carries on a business and this brings the derivation of business income provisions into play. [Section 12 of the Act.]
– In the course of business, Stadium Berhad sells manufactured goods outside Malaysia.
– Under the derivation provisions, this means that all of the gross income from the sale to United States customers is deemed to be business income of Stadium Berhad derived from Malaysia. [Section 12(1)(b)(i).]

(ii) In the case of the supply of computer chips to the factory in the Asian republic, the relevant factors are:

– The derivation of business income provisions apply to the business carried on by Stadium Berhad but there is no gross income from sale because the computer chips are not sold.

– However, there is an export without a sale of goods manufactured in Malaysia. Consequently, the market value of the goods at the time of export is deemed to be business income of Stadium Berhad derived from Malaysia. [Section 12(1)(b)(ii).]

(b) The three traditional methods of determining the arm's length price of a transaction under Malaysia's transfer pricing guidelines are:

(i) Comparable uncontrolled price (CUP) method

This may be used to examine the price at which a Malaysian enterprise sells its product to a related enterprise. It involves comparing the selling price of the product with that of an independent manufacturer of the same product. Where the transactions being compared are not identical, the comparison is still possible if reasonably accurate adjustments can be made to eliminate any material differences.

(ii) Resale price method

This method can be applied where a Malaysian enterprise has acquired a product from an associated enterprise. The starting point is the price at which the product is sold to an independent enterprise by the Malaysian enterprise. The object is to adjust the buying price so as to give the Malaysian enterprise the profit margin it would have enjoyed under an independent transaction.

(iii) Cost plus method

This method can be used when a Malaysian manufacturer sells to an associated enterprise. The starting point is the cost to the manufacturer. The object is to determine how much mark up the manufacturer could have expected to earn on a similar sale to an independent enterprise. If necessary, the selling price will be adjusted.

4 (a) (i) Before a company can be a Malaysian International Trading Company (MITC) the Malaysian External Trade Development Corporation must issue a letter certifying that the following conditions have been fulfilled by the company:

(i) that the company is incorporated in Malaysia and that at least 60% of the issued share capital of the company is Malaysian owned;
(ii) that the company has achieved annual sales of more than RM10 million;
(iii) that not more than 20% of the company's annual sales is derived from the trading of commodities; and
(iv) that the company uses local services for the purposes of banking, finance and insurance and uses local ports and airports.

(ii) The following items are excluded from the meaning of export sales:

(i) trading commissions and profits derived from trading on the Commodity Exchange;
(ii) sales to the Free Industrial Zones; and
(iii) sales to Licenced Manufacturing Warehouses.

(b) Superlative Trading Sdn Bhd:

Year of assessment	2006 RM000	2007 RM000	2008 RM000
Export sales:			
Locally manufactured goods	34,500	55,000	50,000
Export of imported goods – 90% of CIF prices	13,500	18,000	21,600
Total	48,000	73,000	71,600
Increase		25,000	–
Qualifying amount – 20%		5,000	–
Business adjusted income		7,500	4,000
Capital allowances		(1,500)	(1,000)
Statutory business income before exemption		6,000	3,000
Exemption for increased exports – max 70%		(4,200)	(800)
Statutory income – business		1,800	2,200
– interest		650	700
Chargeable income		2,450	2,900
Transfer to exempt account		4,200	800
Balance of qualifying amount carried forward		800	–

5 **(a)** If James makes an early declaration of his income, the offence he has already committed is likely to be treated as the submission of incorrect returns [section 113]. On conviction by the court, a penalty of RM1,000 up to RM10,000 plus a special penalty of double the tax undercharged can be imposed but it is more likely that a compound penalty will be imposed by the Director General.

If James fails to act and it is established later that he failed to declare his own income with the intention of assisting another person (his brother John) to evade tax, the offence can be treated as wilful evasion [section 114]. In that case, the penalty on conviction can be a fine of RM1,000 up to RM20,000 or imprisonment for up to three years, or both, and a special penalty of treble the amount of tax undercharged.

(b) 'Malaysia' means:

- the territories of the Federation of Malaysia;
- the territorial waters of Malaysia and the sea bed and subsoil of the territorial waters; and
- any area extending beyond the limits of the territorial waters of Malaysia, and the sea bed and subsoil of any such area, which has been or may hereafter be designated under the laws of Malaysia as an area over which Malaysia has sovereign rights for the purposes of exploring and exploiting the natural resources, whether living or non-living.

(c) An advance ruling may be revoked by the Director General in any of the following circumstances:

(i) The arrangement is materially different from the arrangement stated in the ruling.
(ii) There was a material omission or misrepresentation in, or in connection with the application of the ruling.
(iii) The Director General makes an assumption about a future event or another matter that is material to the ruling and that assumption subsequently proves to be incorrect.
(iv) The person fails to satisfy any of the conditions stipulated by the Director General.

[Section 138B]

			Marks	
1	**(a)**	Treatment of rental income		
		The availability of loss relief under section 4(a)	3·0	
		The availability of capital allowances under section 4(a)	2·0	
		Confirmation that neither relief applies under section 4(d)	1·0	6
	(b)	**(i)** Why Peacock Sdn Bhd does not qualify for the year of assessment 2006	1·0	
		Why Peacock Sdn Bhd does qualify for the year of assessment 2007	1·0	2
		(ii) – The time when the qualifying period commences		1
		– The time when the qualifying period ends		1
		(iii) Qualifying for a 100% set off:		
		It is located in a promoted area	1·0	
		That is Sabah, Sarawak, Labuan Federal Territory, Perlis, Kelantan, Terrenganu, Pahang and Mersing in Johor	1·0	
		It has achieved the prescribed level of productivity (the PE ratio)	1·0	3
	(c)	**(i)** Explanation of control transfer implications		
		The acquisition is a control transfer – more than 50%	1·0	
		Actual transfer price ignored	1·0	
		Jupiter Berhad is entitled to claim initial and annual allowances based on Venus Sdn Bhd's actual acquisition price	1·0	3
		(ii) Capital allowances		
		Computation/Schedule 1:		
		Previous years' qualifying plant expenditure	0·5	
		Current year's qualifying plant expenditure for annual allowances:		
		Borer	1·0	
		Grinder	1·0	
		Initial allowance YA2007	0·5	
		Annual allowance YA2007	0·5	
		Unabsorbed capital allowances carried forward YA2007	0·5	
		Annual allowance YA2008	0·5	
		Unabsorbed capital allowances brought forward	0·5	
		Written summary identifying key figures in the letter	1·0	6
		(iii) Explanation of control transfer implications		
		Control transfer provisions apply for reinvestment allowance	1·0	
		The deemed acquisition price for the grinder is the residual expenditure of Mercury Sdn Bhd	1·0	
		For the borer, the actual acquisition price is used because the asset was acquired by Venus Sdn Bhd during its final period.	1·0	3
		(iv) Reinvestment allowance		
		Computation/Schedule 2:		
		Qualifying expenditure – borer	0·5	
		Qualifying expenditure – grinder	1·5	
		Reinvestment allowance for YA2007	1·0	
		Unabsorbed reinvestment allowance brought forward YA2007	0·5	
		Unabsorbed reinvestment allowance brought forward YA2008	0·5	
		Allowances utilised for YA2008	0·5	
		Unabsorbed reinvestment allowance carried forward YA2008	0·5	
		Written summary identifying key figures in letter	1·0	6

		Marks	
(v)	**Chargeable income**		
	Computation/Schedule 3:		
	Unabsorbed adjusted loss carried forward YA2007	0·5	
	Statutory income YA2008 – correct basis of calculation, properly described	1·0	
	Reinvestment allowances limited to 70%	1·0	
	Unabsorbed losses brought forward YA2008 (limited)	1·0	
	Unabsorbed adjusted loss carried forward	0·5	
	Written summary identifying key factors in letter	1·0	5
	Appropriateness of the format and presentation of the letter	1·0	
	Effectiveness with which the information is communicated, including appropriate use of appendix/Schedule	1·0	2
	Total		**38**

2 Report to Johari, Khairul and Lisa

(i)	**Trading stocks**		
	Recommend use of book value with reason	2·0	
	Illustrate distortions if higher/lower value used (2 x 1)	2·0	4
(ii)	**Trade debtors**		
	Effect of transfer at book value (2 x 1)	2·0	
	Recommend making a specific provision	2·0	4
(iii)	**Short-life assets**		
	Identify replacement basis treatment as appropriate	1·0	
	Implications of a transfer at value (2 x 1)	2·0	
	Recommend transfer at no consideration	1·0	4
(iv)	**Commercial vehicles**		
	Not a disposal subject to control with reason	1·0	
	Implications of transfer	3·0	
	Recommend transfer values (2 x 1)	2·0	
	Identify the ability to claim CAs in Newco	1·0	7
(v)	**Motor cars for the use of the partners**		
	Basic principles as for commercial vehicles	1·0	
	Additional implications of restricted qualifying expenditure	2·0	
	Recommend transfer at market value with reasons	2·0	
	Consider implications for individuals	3·0	8
(vi)	**Freehold shop premises**		
	No tax implications as such	1·0	
	Recommend transfer at market value with reason	2·0	3
	Appropriateness of the format and presentation of the report	1·0	
	Effectiveness with which the information is communicated	1·0	2
	Total		**32**

				Marks	
3	**(a)**	**(i)**	**Gross income from the sale of computer chips to the United States**		
			Identify relevant factors	1·0	
			Conclude gross income is deemed to be business income derived from Malaysia	2·0	3
		(ii)	**Gross income from the supply of computer chips to an Asian republic**		
			Identify relevant factors	2·0	
			Conclude market value at the time of export is deemed to be business income derived from Malaysia	1·0	3
	(b)		**Methods of determining the arm's length price**		
			For each method:		
			Identify method and circumstances of use	1·0	
			Describe method	2·0	
				3·0	
			x 3 methods		9
			Total		**15**
4	**(a)**	**(i)**	**Conditions to be fulfilled before a company can be a MITC**	1 mark each = max. 2	
		(ii)	**Exclusions from the meaning of export sales**	1 mark each = max. 2	
	(b)		**Computation:**		
			Export sales – locally manufactured goods	1·5	
			Export sales – imported goods	1·5	
			Increase	0·5	
			Qualifying amount	1·0	
			Business adjusted income	0·5	
			Capital allowances	0·5	
			Statutory business income before exemption – for description	0·5	
			Exemption for increased exports	2·0	
			Statutory income – interest	0·5	
			Chargeable income – for description	0·5	
			Transfer to exempt account	1·0	
			Balance of qualifying amount carried forward	1·0	11
			Total		**15**
5	**(a)**		**Consequences for James of non-disclosure**		
			The offence of submission of incorrect returns [section 113]	3·0	
			The offence of wilful evasion [section 114]	3·0	6
	(b)		**'Malaysia' means**		
			The territories of the Federation of Malaysia and the territorial waters of Malaysia and the sea bed and subsoil of the territorial waters	1·5	
			Any area extending beyond the limits of the territorial waters of Malaysia, and the sea bed and subsoil of any such area	1·5	3
	(c)		**Revocation of an advance ruling**		
			For each correct item, 2 marks		
			Maximum		6
			Total		**15**