

THE MALAYSIAN INSTITUTE CERTIFIED PUBLIC ACCOUNTANTS
(INSTITUT AKAUNTAN AWAM BERTAULIAH MALAYSIA)

MAY 2010 WORKSHOP SESSIONS

ADVANCED TAXATION

PROJECT PAPER

Plagiarism will not be condoned and will be severely dealt with (this includes reporting the student to his/her sponsoring firm and awarding ZERO).

Part A (15 marks)

ALL PARTS ARE RELATED

Dinamik Sdn Bhd is a licensed manufacturer of gloves for which it had registered its brand name in Malaysia. The company is a wholly-owned Malaysian company and operates its manufacturing activities out of its factory building located in Behrang, Perak. The management and control of the company is exercised in Malaysia since its incorporation in January 2002. Fifty percent of its finished products are exported to foreign countries.

Usually, Dinamik Sdn Bhd closes its account to 30 June annually, However, on 1 July 2006, it decided to change its accounting date to 31 December. The company prepared the account and computed the adjusted income for each of the accounting period as follows:

	Adjusted income
	RM'000
Year ended 30 June 2006	190,000
1 July 2006 – 31 December 2006	210,000
1 January 2007 – 31 December 2007	230,000

In the year of assessment 2008, the estimates of income tax payable is RM200,000 and it did not make any revision of the estimates thereafter.

Required:

- (a) Calculate the adjusted income for the year of assessment 2007. (4 marks)
- (b) Calculate the minimum amount of estimated tax payable of Dinamik Sdn Bhd for the year of assessment 2009. (4 marks)
- (c) Calculate the penalty liable by Dinamik Sdn Bhd if the actual tax charged for the year of assessment 2009 is RM310,000. (7 marks)

Cite relevant legislative provisions to support your answers. You may wish to present your answers in the following way

(a)	Workings	Adjusted income	Reference
(b)	Workings	Minimum amount of estimated tax	Reference
(c)	Workings	Penalty	reference

Part B (20 marks)

Mr Tony is Dinamik Sdn Bhd's accountant and responsible for the preparation of financial accounts and tax return for the company. For the year ended 31 December 2009, Dinamik Sdn Bhd had earned a profit before taxation of RM900,000. He had a meeting with his managing director, Mr Donny to discuss certain tax issues of the company.

Mr Donny insisted that the expenses incurred for giving mugs free of charge to its customers upon the purchase of gloves are fully deductible. The mugs were bought from a supplier and do not carry the company's logo. Based on his opinion, the expenses incurred are wholly related to sales, thus deductible against gross income from business.

The meeting was then adjourned because other urgent matters arise. Mr Donny also instructed Mr Tony to treat all other expenses charged to the profit and loss account as expenses qualify for double deduction.

Eventhough Mr Tony did not agree with Mr Donny's instruction on the tax treatments, he did prepare the tax return form as instructed and submitted the company's Form C within a week as it is due for submission to the Inland Revenue Board. The tax return form was duly signed by the managing director on behalf of the company.

Among the expenses charged to the profit and loss account are as follows:

1. RM90,000 professional fees incurred in packaging design paid to a foreign company.
2. Insurance premium of RM30,000 paid to an insurance company incorporated in United Kingdom, for insuring raw materials imported from foreign country.
3. Advertisements in newspapers costing RM10,000 to promote the company's brand name.
4. Leave passage provided to employees amounted to RM20,000.
5. Cash contribution of RM20,000 to an approved research institute.
6. Legal fees of RM30,000 incurred in trade debt recovery.

7. Bad debts amounting to RM50,000 related to a loan given to a supplier of raw materials. Dinamik Sdn Bhd gave the loan with the intention of helping the company to supply the raw materials. Later, the supplier's company was liquidated and was unable to repay the loan to Dinamik Sdn Bhd.
8. Repairs to the managing director's office amounting is to RM15,000. The door to the office had been totally replaced with new specification and materials.

The profit and loss account also includes the profit on disposal of a motor vehicle amounting to RM40,000. The motor vehicle which was not licensed for commercial purposes was acquired for RM160,000 on 31 March 2007. Dinamik Sdn Bhd disposed the motor vehicle to its wholly-owned subsidiary company for RM60,000 on 31 May 2009.

Required:

- (i) Explain the basis of deductibility of expenses incurred for the purchase of mugs that was given as free gifts to its customers according to the Malaysian tax law.
(3 marks)
- (ii) Explain the possible tax effects to Dinamik Sdn Bhd with respect to the acquisition of the motor vehicle on 31 March 2007 and its disposal on 31 May 2009. Support your answers with workings.
(4 marks)
- (iii) Explain the tax effects on the acquisition of the motor vehicle by the subsidiary.
(2 marks)
- (iv) Do you agree with the tax treatment on the expenses (item 1 to 8) as instructed by Mr Donny? Provides explanation whether you agree or against his instruction with respect to the tax treatments of the expenses charged to the profit and loss account.
(8 marks)
- (v) Analyse the actions taken by all parties concerned. Compare these actions with the relevant sections of the law and consequences for committing such actions.
(3 marks)

Part C (15 marks)

For the purpose of increasing its production capacity, Dinamik Sdn Bhd intends to incur the following forecasted capital expenditure for the years ending 31 December 2010 until 2013:

	2010	2011	2012	2013
	RM'000	RM'000	RM'000	RM'000
Cost of land	1,700	-	-	-
Factory building	1,200	-	-	-
Plant and machinery (note 1)	2,500	600	1,500	2,000
Motor vehicles provided to marketing manager	200	400	100	-

Note 1:

The plant and machinery includes plant and machinery transferred from a subsidiary of Dinamik Sdn Bhd at a cost of RM1,900,000. The subsidiary has claimed reinvestment allowance on the plant and machinery prior to its transfer.

The net book value of the plant and machinery transferred from the subsidiary was RM1,400,000 whilst its residual expenditure as at 1 January 2010 was RM900,000.

The company has forecasted the adjusted income/(loss) and capital allowances for the years ending 31 December 2010 until 2013 as follows:

	2010	2011	2012	2013
	RM'000	RM'000	RM'000	RM'000
Adjusted income/(loss)	5,000	(800)	7,000	6,500
Capital allowances	650	380	1,000	1,500

Additional information:

1. Dinamik Sdn Bhd will receive interest income of RM50,000 annually.
2. The company will donate RM10,000 annually to approved institutions in Malaysia.

Required:

- (a) Explain the factors that determine the eligibility of Dinamik Sdn Bhd in claiming for reinvestment allowance for the years of assessment 2010 until 2013..
(3 marks)
- (b) Compute the amount of total income and the exempt income available to Dinamik Sdn Bhd for the years of assessment 2010 to 2013.
(12 marks)

Show all relevant workings and state the relevant legislative provision.

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SUGGESTED SOLUTIONS

Part A

(a) Workings	Adjusted income (RM'000)	Reference												
Basis Period for year of assessment 2007: 1.7. 2006 – 31.12.2007	210,000 + 230,000 = 440,000	Public Ruling No 7/2001: Where the new accounting period and the last account ending in the same year, the new accounting period will be added with the following accounting period.												
(b) Workings	Minimum amount of estimated tax	Reference												
85% x 200,000	170,000	Section 107C(3): Requires that the estimate of tax payable for a year of assessment must not be less than 85% of the estimated or revised estimate of the income tax payable for the immediate preceding year of assessment.												
(c) Workings	Penalty	Reference												
<table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th></th> <th style="text-align: right;">RM</th> </tr> </thead> <tbody> <tr> <td>Actual tax charged</td> <td style="text-align: right;">310,000</td> </tr> <tr> <td>Estimated income tax</td> <td style="text-align: right;">170,000</td> </tr> <tr> <td>Difference</td> <td style="text-align: right;">140,000</td> </tr> <tr> <td>Less: 30% x 310,000 (margin of error)</td> <td style="text-align: right;">93,000</td> </tr> <tr> <td>Shortfall</td> <td style="text-align: right;">47,000</td> </tr> </tbody> </table>		RM	Actual tax charged	310,000	Estimated income tax	170,000	Difference	140,000	Less: 30% x 310,000 (margin of error)	93,000	Shortfall	47,000	10% x 47,000 = 4,700	Section 107C(10): Provides for penalties on underestimation of income tax payable. 10% penalty is imposed on the excess of 30% difference between the original estimate (if there is no revision) and the actual tax payable upon submission of the tax return.
	RM													
Actual tax charged	310,000													
Estimated income tax	170,000													
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Less: 30% x 310,000 (margin of error)	93,000													
Shortfall	47,000													

Part B

- (i) Business expenses are deductible against the gross income of business if the expenses fall within the meaning of outgoings and expenses which are wholly and exclusively incurred in the production of gross income . (Section 33 of ITA 1967)

The expenses must also be revenue in nature as capital expenditure are not deductible. However, some expenses are given specific deduction (Section 34) eventhough it is not revenue in nature. In certain situations, the expenses may also entitled to double deductions.

The expenses incurred in purchasing the mugs as free gifts to customers are not deductible unless it carries the logo of Dinamik Sdn Bhd. [Section 39(1)(l)] In UDI Sdn Bhd v DGIR [1999] 1 AMR 462 (HC), it was held that expenses can be deductible if it carries the company logo and given free of charge.

- (ii) Dinamik Sdn Bhd is able to claim capital allowances up to RM50,000 only because the cost of the motor vehicles exceeds RM150,000. [para 2(2) of Schedule 3 of the ITA 1967]

Upon disposal, there is no balancing charge nor balancing allowance because disposal value is deemed to be equal to residual expenditure. The disposal of the motor vehicle to a wholly owned subsidiary is subject to control transfer provision.[para 38, schedule 3 of ITA 1967]

	RM
Purchase price	160,000
YA2007	
Qualifying capital expenditure	RM50,000
- IA(20%)	(10,000)
- AA (20%)	<u>(10,000)</u>
Residual expenditure	RM30,000
YA2008	
- AA (20%)	<u>(10,000)</u>
Residual expenditure	20,000
YA2009	
Disposal value	<u>20,000</u>
Balancing adjustment	<u>Nil</u>

- (iii) The subsidiary is deemed to acquire the motor vehicle at qualifying capital expenditure equal to the residual expenditure of RM20,000. It will not entitled to any initial allowance. Annual allowance can still be claimed based on the RM160,000.
- (iv) Only few expenses are entitled to double deductions against the gross income whereas others are only allowable.

Expenses	Tax treatments	Reference
1. RM90,000 professional fees incurred in packing design paid to a foreign company.	The expense incurred is allowable to be deducted against the gross profit but not entitled to double deductions. To be entitled for double deductions, the fees should be paid to a local professional company.	Section 41 of the Promotion of investment Act 1986.
2. Insurance premium of RM30,000 paid to an insurance company incorporated in United Kingdom, for insuring raw materials imported from the foreign country.	The expense incurred is allowable to be deducted against the gross profit but not entitled to double deductions. To be entitled for double deductions, the fees should be paid to a local insurance company.	P.U.(A) 72/82
3. Advertisements to promote brand name in newspapers costing RM10,000.	It is entitled to double deductions.	PU(A) 62/2002
4. Leave passage provided to employees amounted to RM20,000	It is not allowable against the gross income.	Section 39(1)(m)
5. RM20,000 cash contribution to an approved research institute.	Entitled to double deduction.	Section 34 of ITA 1967
6. RM30,000 legal fees incurred in trade debt recovery	It is deductible expense against the gross income as it is incurred wholly and exclusively in the production of gross income of the business.	Section 33 of ITA 1967.
7. Bad debts RM50,000 to a supplier of raw materials.	The bad debts is not deductible as it is a capital loss. The main purpose of giving the loan was to secure the raw materials. Thus, an investment in capital.	Section 34(2) In English Crown Spelter Co. V Baker (5TC 327). (or any other acceptable reference)
8. Repairs to the managing director's office amounted to RM15,000.	The repairs expense is an improvement to the office because the door had been replaced with improved materials and design. Thus, it is a capital expenditure and not deductible.	Section 33(1)(c)

- (v) Making a false entry in a tax return is an act of wilful evasion.

Dinamik Sdn Bhd, Mr Donny and Mr Tony are liable for prosecution for wilful evasion under Section 114 of the ITA 1967. The company is also liable for making an incorrect return under section 113 of the ITA 1967.

As a consequence, any person found to be assisting in, or advises with respect to the preparation of any return where the return results in an understatement of the liability for tax, be guilty of an offence and shall, on conviction, be liable to a fine of not less than two thousand ringgit and not more than twenty thousand ringgit or to imprisonment for a term not exceeding three years or both. [Section 114]

Under subsection 113(1), be liable to a fine of not less than RM1,000 and not more than RM10,000 and shall pay a special penalty of double the amount of tax which has been undercharged.

Part C

- (a) The factors that determine the eligibility for claiming the reinvestment allowance are:
- resident status of the company. The company is resident because the management and control of the business is exercised throughout the year in Malaysia.
 - qualifying capital expenditure incurred for the qualifying project, ie. expansion project, increasing the production capacity.
 - the business has been in operation for at least 36 months before the claim for reinvestment is made.
- (b) The plant and machinery transferred from the subsidiary is subject to control transfer provision [para 38, schedule 3 of ITA 1967]. The qualifying capital expenditure is deemed equal to the residual expenditure RM900,000.

With effect from YA 2009, DSB cannot claim reinvestment allowance on the same asset [Schedule 7A of ITA 1967]. A company purchasing an asset from a related company within the same group where reinvestment allowance has been claimed on that asset is not allowed to claim reinvestment allowance on the same asset. The motor vehicles do not qualify because it is used by the administrative staff.

	2010	2011	2012	2013
	RM'000	2010	2011	2012
Adjusted income/(loss)	5,000	Nil	7,000	6,500
Capital allowance	(650)	(380)	(1,380)	(1,500)
Statutory income	4,350	Nil	5,620	5,000
Less: RA utilised	(1,080)	Nil	(1,260)	(1,200)
	3,270	Nil	4,360	3,800
Less: business loss b/f			(750)	-
			3,610	3,800
Add: interest income	50	50	50	50
Aggregate income	3,320	50	3,660	3,850
Less: current year loss	-	(50)	-	-
Approved donation	(10)	-	(10)	(10)
Total income	3,310	Nil	3,650	3,840

	2010	2011	2012	2013
	RM'000	2010	2011	2012
70% x Statutory income	3,045	Nil	3,934	3,500
Set off against:				
RA: 60% x QCE (w1)	1,080	360	900	1,200
: b/f	-	Nil	360	Nil
Total RA available	1,080	360	1,260	1,200
Ra utilised	1,080	nil	1,260	1,200
Unabsorbed RA c/f	Nil	360	Nil	Nil
Amount credited to exempt income account	1,080	nil	1,260	1,200

W1:

	2010	2011	2012	2013
	RM'000	RM'000	RM'000	RM'000
Factory building	1,200	-	-	-
Plant and machinery	600	600	1,500	2,000
	1,800	600	1,500	2,000
60% x QCE	1,080	360	900	1,200

Feedback on Students' Performance

Part A

- (a) The students were able to determine the basis period for the year of assessment 2007 and the adjusted income. However, majority of them only referred to the section 21A. They should have referred to the Public Ruling 7/2001 and explained the guideline as given in the public ruling.
- (b) They calculated correctly the minimum amount of the estimated tax, which is 85% of the estimated or revised estimate of the income tax payable for the immediately preceding year of assessment. They cited the relevant section 107C(3) in their answers.
- (c) The students calculated correctly the amount of penalty and were able to cite the relevant reference.

Overall comments:

Majority performed excellent with almost full marks. However, the students should have answered on the requirement of the question only because some of them gave the answer for the year of assessment 2006 which was not required.

Part B

- (i) The students were required to explain the basis of deductibility of expenses according to the Malaysian tax law and relate it to the expenses incurred for the purchasing of the mugs as free gifts.

All of the students did not explain the basis of deductibility of expenses. They only answered on the expenses incurred for the purchase of the mugs as free gift.

They should explain that only revenue expenditure are deductible against the gross business income and it should satisfy the 'wholly and exclusively incurred in the production of gross income' test.

Generally, capital expenditures are not deductible but in certain situation, these expenditures are given the specific deductions under Section 34.

The question stated that the managing director's is in the opinion that the expenses are wholly related to sales. The students were supposed to discuss on this issue. The students should argue that giving mugs as free gift without any advertisement or logo of the company would not entitle the company to a deduction. The mugs were not the product of the company and were purchased from other supplier. It would only be entitled to a deduction if it carries the logo of the company. Reference – Public Ruling 3/2008.

- (ii) The students were able to explain that the qualifying capital expenditure is only RM50,000 because the cost of the motor vehicles exceeds RM150,000 but they did not cite paragraph 2(2) of schedule 3 of ITA 1967 as their reference.

Upon disposal of the asset, the students should mention that the transaction fall under control transfer provision (paragraph 38, schedule 3 of the Income Tax Act 1967). As such there would not be any balancing charge or balancing allowance.

- (iii) The students were able to explain the tax effects on the acquisition of the motor vehicles by the subsidiary. They knew that the qualifying plant expenditure equal to the residual expenditure of the disposer. The subsidiary will not entitled to the initial allowance but able to claim the annual allowance based on the original purchase price of the disposer.
- (iv) The students were asked to explain whether they agreed with the opinion of the managing director that all the expenses were to be treated as double deduction expenses. Majority were able to provide explanation with relevant references while other did provide explanation but without any references.
- (v) The students were required to analyse the actions taken by all the parties concerned and the consequences for committing such actions.

The students should know that there were three parties concerned, i.e the company, the managing director and the accountant. Majority only focused on the company and the managing director or the managing director and the accountant. They failed to recognise that all the parties concerned had committed willful evasion and be liable for prosecution.

Overall comments:

The students managed to score more than 55% to 75% of the total marks of 20. In order to score more marks, the students should explain why certain expenses were not entitled to the double deductions together with supporting guidelines or sections in the Income Tax Act 1967.

Part C

- (a) Majority of the students were able to explain the factors that determine the eligibility for claiming reinvestment allowance. However, some still applied the previous rulings. The students should be aware that the business should be in operation for at least 36 months before the claim for reinvestment is made. Previously, it was 12 months.
- (b) Majority of the students were able to calculate the total income and the exempt income available for the years of assessment 2010 to 2013. From their calculations, they knew that with effect from YA 2009, a company will not be able to claim reinvestment allowance on the same asset if the assets were purchased from a related company within the same group where the reinvestment allowance has been claimed. However, the students did not explain how they managed to calculate the qualifying plant expenditure for the reinvestment allowance purposes. The cost of the plant and machinery should not include the cost of plant and machinery acquired from the subsidiary. Majority of them cited the public ruling 2/2008 but did not explain on the guideline.

The students should incorporated the Public Ruling 2/2008 in their answer and not as appendix to the answers. They should also explain why the motor vehicles provided to the marketing manager do not qualify as plant expenditure.

Overall comments:

The students should be aware of the current rulings because this will affect their answers. For every item appeared in the question, the students should support the answers with explanation.