Professional Pilot Paper – Options module

Advanced Taxation (Malaysia)

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

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)

The following rates and allowances are to be used in answering this paper:

Income tax rates

(Rates applicable to all chargeable income liable to tax and not specifically chargeable at a different rate)

Resident individuals and persons not mentioned below

Chargeable income		Tax payable	
Band	Cumulative	Rate	Cumulative
RM	RM	%	RM
2,500	2,500	0	0
2,500	5,000	1	25
15,000	20,000	3	475
15,000	35,000	7	1,525
15,000	50,000	13	3,475
20,000	70,000	19	7,275
30,000	100,000	24	14,475
150,000	250,000	27	54,975
Excess		28	

Resident companies

Having a paid up ordinary share capital not exceeding RM2.5 million	
The first RM500,000	20%
The remainder	28%
Other resident companies	
All	28%

Resident trust bodies and receivers

All	28%

Labuan offshore companies – chargeable income from an offshore business activity

All	3%

Non-residents

All	28%

Selected personal deductions

		RM
Single individual	– basic rate	8,000
	– disabled rate	14,000
Wife/husband	– basic rate	3,000
	– disabled rate	6,500
Child	– basic rate	1,000
	– enhanced rate	4,000
	– disabled rate	5,000
Life insurance and approved schemes		6,000
Parents' medical expenses		5,000
Own medical costs		5,000
Necessary basic supporting equipment		5,000
Educational and medical insurance		3,000

Rebates

	RM
Single individual – chargeable income up to RM35,000	350
Individual entitled to a deduction for a spouse or a former wife – chargeable income up to RM35,000	700

Capital Allowances

	Initial %	Annual %
Industrial buildings	10	3
Plant and machinery – general	20	14
Motor vehicles and heavy machinery	20	20
Computers, information technology equipment and computer software	20	40
Office equipment, furniture and fittings	20	10

Real property gains tax

	Tax rate %		
	A Companies	B Others except C	C 'Non-citizens'
Disposals within the following period after the date of acquisition:			
in the first two years	30	30	30
in the third year	20	20	30
in the fourth year	15	15	30
in the fifth year	5	5	30
in the sixth year or thereafter	5	0	5

For individuals, the first RM5,000 or 10% of any chargeable gain, whichever is greater, is normally exempt from tax.

'Non-citizens' in the above table means individuals who are not citizens and not permanent residents.

Stamp duty

Rates of duty under Item 32(a) of the First Schedule

	Duty 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 MUST be attempted

1 Two unrelated companies Bukit Sdn Bhd and Sungei Sdn Bhd, incorporated another company, Ladang Sdn Bhd and provided its paid-up share capital of RM10,000. Bukit took 51% and Sungei 49% of the shares. Immediately afterwards, on 1 April 2004, Ladang purchased from Bukit certain assets of its ongoing manufacturing business and commenced to carry on a manufacturing business of its own. All of the companies make up accounts to 31 March in each year.

The assets were purchased by Ladang from Bukit at a purchase price of RM500,000 which consisted of:

		Details of acquisition by Bukit	
	Purchase price to Ladang	Cost	In basis period for year of assessment (YA)
	RM	RM	
Registered patents	120,000	80,000	2003
Machinery – general	200,000	280,000	2003
Inventories	180,000	150,000	Various
	500,000		

Ladang also incurred the following amounts of capital expenditure:

Date	Item	Purchase price RM
1 October 2004	Additional machinery to expand manufacturing capacity	300,000
1 June 2005	New production line to automate manufacturing	500,000
1 October 2005	Grinding machine (acquired from Bukit) (cost in basis period for YA2003 RM30,000)	20,000

Ladang took out a bank loan of RM750,000 on 1 April 2004. The balance of the loan money, which amounted to RM250,000 after paying Bukit the purchase price of the assets, was lent to Sungei on an interest-free basis. These loan amounts remained constant throughout the year to 31 March 2005. The interest on the bank loan amounted to RM61,200 for that year.

It has been estimated that Ladang has retained profits of RM450,000 at 31 March 2006 and the directors have proposed that the whole of this should be capitalised and used to enlarge the issued share capital by issuing bonus shares to Bukit and Sungei.

Required:

(a) As tax agent for Ladang Sdn Bhd prepare a report for the company's management dealing with the treatment of certain items in the tax computations for the years of assessment 2005 and 2006. The report should be in four sections covering the following aspects:

(i) Registered patents
Provide an explanation of the annual tax relief available for this expenditure, indicating the stage at which it is deducted in the tax computation.

Illustrate your explanation with a calculation of the amount of the relief available for each year.
(6 marks)

(ii) Capital allowances for plant and machinery
Provide an explanation of the amount treated as qualifying plant expenditure in the case of any asset for which the cost to Ladang is not used as the qualifying expenditure. (4 marks)

(iii) Reinvestment allowance.
Indicate why Ladang is not eligible to claim reinvestment allowance on the additional machinery purchased to expand its manufacturing capacity on 1 October 2004.

Examine the factors which determine when the qualifying period commences and when it ends and provide a conclusion.

Provide an explanation of the amount treated as qualifying capital expenditure in the case of any asset for which the cost to Ladang is not used as the qualifying expenditure.

Illustrate your answers to the above by providing a calculation of the expenditure qualifying for reinvestment allowance for the year of assessment 2006.

Discuss the way in which effect is given to the reinvestment allowance, including the way in which the allowance is restricted where the qualifying project is not located in a promoted area, and indicating the stage at which effect is given to it in the tax computation, (12 marks)

(iv) Interest expense
Give an explanation of the treatment of the interest incurred by Ladang on the bank loan, indicating the reason for its deductibility and the reason for any restriction on deductibility.

Illustrate your answer with a calculation of the amount of interest deductible for the year of assessment 2005. (5 marks)

Appropriateness of format and presentation of the report and the effectiveness with which the information is communicated. (2 marks)

(b) The proposed bonus issue
Advise on whether the proposal to issue bonus shares has any tax implications for Ladang.

Discuss the overall tax efficiency of the proposed bonus issue taking into account the interests of all three companies involved and recommend any alternative that you think would be better. (7 marks)

(36 marks)

2 Kenneth Leong has set up a company, Kenneth Leong Snacks Sdn Bhd ("KLS") to carry on a fast food operation in a busy town in Johor as a franchise operation. The intended franchisor is Fill-em-up Foods Inc ("Fill-em-up"), a foreign-resident company with no place of business in Malaysia, which has developed its own brand of fast food. The arrangement with Fill-em-up will require KLS to make the following payments to Fill-em-up:

– Franchise fee, being a single lump sum amount payable on signing the franchise agreement, which will give KLS the right to do business at its chosen location using the name "Fill-em-up" for a stipulated period of years with an option to renew on payment of a further lump sum.
– A monthly royalty based on sales by KLS payable for the duration of the franchise.

The following information is also available:

(i) KLS will have a paid-up capital of RM300,000. Kenneth Leong and his wife will be the directors.

(ii) KLS intends to commence business on 1 January 2007 and will make up its first accounts to 31 December 2007.

(iii) Kenneth Leong plans to purchase the business premises in his own name at a cost of RM1,200,000 with the help of a bank loan of RM1,000,000 and a loan from his wife. The bank loan is repayable over 15 years at RM10,000 per month, which includes the first year's interest of RM8,750. Kenneth will rent the property to KLS for RM7,000 per month which is the market rental.

(iv) Two commercial vehicles are to be bought on hire-purchase with a RM100,000 down-payment and 60 monthly instalments of RM15,000 commencing in January 2007. The cash purchase price of the vehicles is RM800,000.

(v) Kenneth has no money of his own but his wife has RM500,000. She will put up the RM300,000 of paid-up share capital for KLS, becoming the only shareholder, and she will make a loan of RM200,000 to Kenneth to help him to purchase the business premises. Kenneth has agreed to repay his wife's loan on the same basis as the loan from the bank.

(vi) For its first year of trading KLS is expected to make a profit of RM550,000 arrived at after charging royalties to Fill-em-up but before making any deduction for rent, interest, the franchise fee or the directors fees.

(vii) Kenneth is to be paid a directors fee of RM60,000 per annum and his wife a directors fee of RM30,000 per annum. There will be no EPF. Neither of them have any other income

Required:

(a) Assess the nature of the payments to be made to Fill-em-up Foods Inc and conclude on the reasons why Kenneth Leong Snacks Sdn Bhd is required to deduct tax at source on paying royalties but not on paying the franchise fee. (7 marks)

(b) Provide a computation of the estimated income tax liability of Kenneth Leong Snacks Sdn Bhd for its first year of assessment and state the amount and timing of the income tax instalments to be paid by the company during the basis period for the year of assessment 2007, assuming that the estimated tax you have computed is used as the first estimate for income tax purposes. (7 marks)

(c) Explore the tax efficiency of the proposed business arrangements for Kenneth Leong Snacks Sdn Bhd and the two individuals concerned and recommend any variation(s) that you believe would improve it. Support your conclusions/recommendations with calculations where relevant. (10 marks)

You may assume that the tax rates and allowances applicable for the year of assessment 2006 will continue to apply for the foreseeable future.

(24 marks)

Section B – TWO questions ONLY to be attempted

3 Skyhigh Sdn Bhd is a property dealer and developer but the company has been inactive for some years. The shares are held by three family members in the following proportions:

	No. of shares held	%
Weng Keat	6,000	30
Set Pew (Weng Keat's wife)	3,000	15
Eng Choon (Set Pew's father)	11,000	55
Total	20,000	100

A decision was reached to re-activate the company in order to develop a piece of land near Seremban, part of which was owned by Weng Keat. On 31 March 2006, Weng Keat sold his land to Skyhigh for RM12,000, its market value at that time. The sale consideration consisted of 10,000 new shares in Skyhigh and RM2,000 in cash.

Nancy owned the plot of land adjoining Weng Keat's. On 15 April 2006, she sold her land to Skyhigh for RM16,000. The sale consideration was satisfied by the issue of 12,000 new shares in Skyhigh and payment of RM4,000 in cash. Nancy is not related to any of the other parties but she is the wife of Eng Choon's business partner.

The respective acquisition details are:

– Weng Keat: He acquired his plot on 1 April 2003 for a purchase price of RM5,000, with incidental expenses of RM800.
– Nancy: She received her plot as a gift from her husband on 1 July 2003, when it had a market value of RM8,000. Nancy's husband had bought the land himself on 1 April 2002 for a purchase price of RM6,000, with incidental expenses of RM1,000.

On 16 April 2006, Skyhigh transferred both land plots to its trading stock at the following values:

Weng Keat's plot	RM15,000
Nancy's plot	RM20,000

Required:

(a) Explain why Weng Keat has no liability to real property gains tax on transferring his land to Skyhigh Sdn Bhd. (4 marks)

(b) Advise Nancy on the reason why, unlike Weng Keat, she has a liability to real property gains tax on selling her land to Skyhigh Sdn Bhd.

Explain how the acquisition price of the land will be determined and provide a computation of Nancy's liability to real property gains tax. (8 marks)

(c) Explain to the management of Skyhigh Sdn Bhd why the company has incurred a liability to real property gains tax in respect of the taking into stock of the plots of land.

Explain how the chargeable gain will be determined and provide a computation of the company's liability to real property gains tax. (8 marks)

(20 marks)

4 **(a)** Two individuals, Ahmad and Ibrahim, who are architects carrying on a professional partnership, intend to transfer their activity into a new company A&I Sdn Bhd. The following information is available:

(1) Accounts have been and will continue to be made up to 31 December each year.

(2) Under the existing partnership agreement, profits are shared by Ahmad and Ibrahim in the proportions 55% and 45% respectively with no partners' salaries. It is agreed that Ahmad and Ibrahim will draw salaries as directors of A&I Sdn Bhd at the rates of RM20,000 and RM15,000 per month respectively.

(3) All of the partnership assets, but not the liabilities, are to be transferred to A&I Sdn Bhd for a consideration of RM1 million made up as follows:

	RM
Office equipment including computers – at book value	100,000
Work in progress at market value (cost is RM90,000)	120,000
Trade debtors	150,000
Bank balance	330,000
Goodwill at market value (cost is nil)	300,000
	1,000,000

(4) In consideration for the transfer of the assets, one million fully paid shares of RM1 each are to be issued, 500,000 to each partner. This implies a transfer of a 5% interest from Ahmad to Ibrahim but it is agreed that there will be no balancing payment by Ibrahim.

(5) The office equipment including computers is to be transferred at book value which is estimated to be the same as market value. Some assets are fully written off for tax purposes and have no residual values.

(6) Work in progress is valued at cost by reference to the time input of salaried staff. Nothing is included for the time input of partners.

(7) Trade debtors are estimated to be good apart from one doubtful debt of RM20,000 against which no provision has been made.

Required:

Advise Messrs Ahmad and Ibrahim on the tax consequences of the following aspects of transferring the partnership business to A&I Sdn Bhd:

(i) The tax adjustments, if any, on the disposal by Ahmad and Ibrahim of the office equipment. (5 marks)

(ii) The tax implications for Ahmad and Ibrahim, if any, on the disposal of:
- **the work in progress;**
- **the trade debtors; and**
- **the business goodwill** (4 marks)

(iii) The tax implications, if any, of issuing 50% of the shares to Ibrahim as consideration for his 45% partnership interest. (2 marks)

(iv) The tax implications for A&I Sdn Bhd, if any, of including a large bank balance with the assets to be transferred to the company. (3 marks)

(v) The entitlement of A&I Sdn Bhd to capital allowances on the assets acquired and the acquisition values to be used. (2 marks)

(vi) Whether the future value of work-in progress for A&I Sdn Bhd will differ in principle from that adopted in the partnership accounts, and if so, why. (2 marks)

Ignore stamp duty.

(b) A&I Sdn Bhd is expected to be eligible to claim the allowance for increased export of services to 'foreign clients'. Architecture is one of the eligible activities.

Required:

Provide an explanation of the requirements for a company and an individual, respectively, to qualify as a foreign client for the purpose of the exemption. (2 marks)

(20 marks)

5 (a) Mr Leong is an accountant employed by Shiny Parts Sdn Bhd and it is part of his duties to prepare financial accounts and tax returns for the company. Mr Leong has drawn to the attention of his managing director the fact that only entertainment expenses which are wholly related to sales as indicated by the Inland Revenue Board Public Ruling No. 3/2004 can be given a 100% deduction. However, the managing director has insisted that all entertainment expenses be treated as 100% allowable, based on his view that, as the company's business is to sell its products, there is no question of any entertainment not being wholly attributable to sales. Mr Leong has prepared and submitted the company's Form C without any explanation as instructed by the managing director. It was signed by the managing director on behalf of the company.

Required:

Analyse the actions taken by the parties concerned, compare them with the relevant sections of the law and any relevant public ruling, and conclude on the offences, if any, that have been committed by the parties concerned and any mitigating circumstances. (9 marks)

(b) Quicksale (Labuan) Limited ("Quicksale") is incorporated in Labuan under the Offshore Companies Act 1990 and carries on business from Labuan. The business consists of buying electronic goods from China and selling them in Europe and North America.

The trading and profit and loss account of Quicksale for the year ended 31 December 2005 was as follows:

	RM	RM
Sales		3,478,000
Cost of sales		1,450,000
Gross profit		2,028,000
Less:		
Provision for doubtful debts	25,000	
Depreciation	80,000	
Interest	120,000	
Other overheads	175,000	400,000
Trading profit		1,628,000
Malaysian dividend – net of tax at 28%		72,000
Capital gain on the sale of shares		50,000
Profit before zakat and tax		1,750,000
Zakat		18,000
Profit before tax		1,732,000

Required:

(i) Explain the basis of taxation of an offshore company. (2 marks)

(ii) Based on the information given above, compute the tax liability of Quicksale (Labuan) Limited for the relevant year of assessment (which should be specified) assuming that no elections are made. (3 marks)

(iii) Advise whether it would be beneficial for Quicksale (Labuan) Limited to make the election it is entitled to make for the year of assessment concerned, the date by which it must be made and the tax consequences of making it. (3 marks)

(c) With regard to the payment of dividends by an offshore company:

(i) State whether there are any restrictions on the amount payable;

(ii) Explain how such a dividend would be treated in the hands of a domestic company or individual; and

(iii) Describe the tax consequences of an onshore company paying a dividend out of its Labuan dividend income. (3 marks)

(20 marks)

End of Question Paper

Answers

1 **(a)** Report to the management of Ladang

To The management of Ladang Sdn Bhd
From Tax agents
Date 1 October 2006
Subject Tax computations for the years of assessment 2005 and 2006

(i) Registered patents

A relief is given to a manufacturing company for the cost of acquisition of proprietary rights, including patents registered under written law. The relief is given as a deduction in arriving at business adjusted income at the rate of one-fifth of the cost for each year of assessment commencing from the year of acquisition. Where a subsidiary acquires such rights from its parent company, the subsidiary is allowed to continue claiming the deduction based on the original cost of acquisition by the parent company until the parent and subsidiary between them have exhausted the original cost.

Ladang is a subsidiary of Bukit due to the 51% majority shareholding owned by the latter so a deduction of RM16,000 (one-fifth of RM80,000) will be given to Ladang for each of the years of assessment 2005 and 2006.

(ii) Capital allowances for plant and machinery

Due to the 51% majority shareholding owned by Bukit at the time of acquisition, the purchase of items from Bukit, the general machinery acquired on 1 April 2004 and the grinding machine acquired on 1 October 2005, are transfers subject to control. Consequently, Ladang is deemed to have acquired each asset for a sum equal to Bukit's residual expenditure. No initial allowance can be claimed, but Ladang can continue to claim annual allowances based on the original cost to Bukit until the residual expenditure is exhausted.

(iii) Reinvestment allowance

The additional machinery purchased on 1 October 2004 to expand Ladang's manufacturing capacity does not qualify for reinvestment allowance because the company had not been in operation for at least twelve months at that time.

Once a company has been in operation for twelve months, and has incurred capital expenditure on a factory, plant or machinery used in Malaysia for a qualifying project, its fifteen-year qualifying period will commence from the beginning of the basis period in which that expenditure takes place. In the case of Ladang, the expenditure incurred on the new production line on 1 June 2005 is the first expenditure to satisfy this requirement. Therefore, the company's qualifying period will commence on 1 April 2005 and end on the last day of the basis period for the year of assessment 2020 (31 March 2020, assuming that the basis period remains unchanged.)

In the case of the grinding machine, Ladang is not eligible to claim reinvestment allowance based on its cost due to the fact that Ladang is under the control of the disposer (Bukit.) The amount eligible for reinvestment allowance is the amount of Bukit's residual expenditure on the first day of its final period.

Expenditure qualifying for reinvestment allowance for the year of assessment 2006

	RM	RM
New production line		500,000
Grinding machine		
Cost	30,000	
YA 2003 IA 20%	(6,000)	
YA 2003 AA 14%	(4,200)	
YA 2004 AA 14%	(4,200)	
YA 2005 AA 14%	(4,200)	
Bukit's residual expenditure at 1 April 2006		11,400
Qualifying expenditure		511,400

Effect is given to the reinvestment allowance by way of an exemption from income tax. This is achieved by setting off the allowance for the year of assessment concerned, including any brought forward from an earlier year, against the statutory business income of the year. Where the qualifying project is not located in a promoted area, the set off for each year is restricted to 70% of the statutory business income. Any amount which cannot be set off due to this restriction, or to an insufficiency of statutory business income, can be carried forward to the following year.

(iv) Interest expense

The interest incurred by Ladang on the bank loan qualifies for deduction in arriving at the business adjusted income because the money borrowed is either employed in the production of gross income from the business (inventories) or laid out on assets used or held for the production of gross income from the business (patents and machinery.) However, a restriction applies because Ladang has made a loan (to Sungei) and that loan is still outstanding.

The interest deductible for the year of assessment 2005 is calculated as follows:

	RM
Bank interest for the whole year	61,200
Deemed monthly amount RM61,200 ÷ 12	5,100
Amount of the loan to Sungei outstanding at the end of each month	250,000
Amount of the bank loan outstanding at the end of each month	750,000
Restriction fraction 250,000 ÷ 750,000 = 1/3	
Monthly amount after restriction RM5,100 – 1/3	3,400
Interest deductible for the whole year 3,400 x 12	40,800

(b) The proposed bonus issue

When a Malaysian-resident company pays, credits or distributes a dividend, it has tax implications. However, a bonus issue of shares in not regarded as a distribution of income because the funds remain with the company and do not pass to the shareholder [Comptroller of Income Tax v Blott 8 TC 101.]

Nevertheless, this does not seem to be the most tax-efficient way to achieve the desired objective of increasing the paid-up share capital. Although no specific information is available about dividend franking balances, it seems obvious that the company will have both an exempt account and a section 108 balance. By declaring dividends, these balances could be passed up to the shareholders, Bukit and Sungei, so that those companies could use them in paying their own dividends. However, by dissipating all of the distributable profits, the ability of Ladang to declare dividends will be severely constrained. It is suggested that a better way to proceed would be for Ladang to declare dividends, both exempt and taxable, to the extent that franking balances permit. These dividends would be credited to the accounts of the shareholders rather than being paid in cash and the credit balances available to the shareholders could then be used to subscribe for new shares in Ladang.

2 (a) The franchise fee is not an expense of a revenue nature because it is made "not only once and for all, but with a view to bringing into existence an asset or advantage of an enduring nature" [British Insulated and Helsby Cables v Atherton 10 TC 155]. As such, it is not an allowable deduction for KLS. On the other hand, the royalty payments have regularity and are wholly and exclusively incurred in producing gross income of the company's business and are tax deductible. However there is another tax implication.

KLS, being a Malaysian resident, has an obligation to deduct tax at the rate in force (currently 10%) on paying royalties to a non-resident. Although the payment of the franchise fee (as a payment for the right to use patents, know how etc) also comes within the statutory definition of royalty, it appears to arise to Fill-em-up as an incident of its business and would therefore constitute business income rather than royalty income. As such, Fill-em-up would not be liable to tax in Malaysia because it has no permanent establishment in Malaysia. Consequently, it is only the actual royalties which attract withholding tax.

(b) KLS – estimate of income tax liability for the year of assessment 2007:

	RM	RM
Profit before rent, interest, franchise fee and directors fees		550,000
Less: Rent RM7,000 x 12	84,000	
Hire-purchase interest = (RM100,000 + (RM15,000 x 60) – RM800,000) x 12/60	40,000	
Directors fees RM60,000 + RM30,000	90,000	214,000
		336,000
Capital allowances based on RM240,000 (RM100,000 + (RM15,000 x 12) – RM40,000)		
Initial 20%	48,000	
Annual 20%	48,000	96,000
		240,000
Tax payable at 20%		48,000

The estimated tax payable during the basis period 1 January 2007 to 31 December 2007 is RM28,000, which is seven monthly instalments of RM4,000 (RM48,000 ÷ 12) commencing on 10 June 2007.

(c) Comments on tax efficiency:

- Business premises. As KLS is profitable, a full tax deduction is available for the rent payable to Kenneth (RM7,000 x 12 = RM84,000). Also, Kenneth has sufficient rental income to obtain a full deduction for the interest payable to the bank (RM8,750) and to his wife (RM1,750 = RM8,750 x RM200,000/RM1,000,000) so the arrangement is tax-efficient.
- Commercial vehicles. As KLS has sufficient income to fully offset all of the interest charges and capital allowances, the arrangement is tax-efficient.
- Kenneth and his wife. There is an imbalance between husband and wife resulting in some loss of tax-efficiency. The tax position of Kenneth and his wife will be as follows:

	Kenneth		Wife
	RM	RM	RM
Directors fees		60,000	30,000
Rent	84,000		
Less: interest to bank	(8,750)		
interest to wife	(1,750)	73,500	
Interest from Kenneth			1,750
		133,500	31,750
Personal relief		(8,000)	(8,000)
Chargeable income		125,500	23,750
Marginal rate of tax		27%	7%

Kenneth's wife is not making full use of her graduated tax rates. One obvious step to improve tax-efficiency would be for KLS to declare dividends so that the wife, apparently the only shareholder, can make use of the section 110 tax credit. A gross dividend sufficient to use up all of the dividend franking credit available to KLS (potentially about RM170,000 by 10 February 2008) would ensure that the tax credit of 28% would be more than the marginal rate of tax payable.

	RM
Tax payments up to 31 December 2007 as in (b)	28,000
Tax payments due from January 2008 to May 2008 = 5 x RM4,000	20,000
	48,000
Possible gross dividend RM48,000 x 100/28	171,428
Tax credit available at 28%	48,000

3 (a) Weng Keat

Weng Keat's has no liability to real property gains tax on transferring his land to Skyhigh because the transfer qualifies for no gain/no loss treatment. The reason for this is that the transfer was made by Weng Keat to a company controlled by him and connected persons for a consideration consisting of shares in the company to the extent of at least 75%.

Both Set Pew and Eng Choon are connected to Weng Keat (as well as to each other) because they are within the specified degrees of relationship, spouse and parent of spouse respectively. The shares held by Weng Keat and Eng Choon exceed 50%, which is sufficient for this purpose.

(b) Nancy

Nancy has a real property gains tax liability because, unlike Weng Keat's, her sale to Skyhigh is not a no gain/no loss transfer. The reason is that, at the time of the transfer, the only shareholder to whom she was connected was Eng Choon and he, holding only 11,000 out of the 30,000 shares in issue on 15 April 2006, was not in control of the company. Nancy is connected to Eng Choon because she is the wife of his business partner but she is not connected to Weng Keat or to Set Pew.

When Nancy acquired the plot of land from her husband, it would have been treated as a no gain/ no loss disposal by him. Consequently, Nancy is deemed to have acquired the land at an acquisition price equal to her husband's acquisition price plus permitted expenses incurred by him (RM6,000 + RM1,000).

Nancy's liability to real property gains tax is thus:

	RM
Disposal price	16,000
Deemed acquisition price	(7,000)
Chargeable gain	9,000
Less. Exemption, RM5,000 being greater than 10%	(5,000)
	4,000
Disposal date 15 April 2006	
Acquisition date 1 July 2003	
Tax at 20% (disposal within the third year of ownership)	800

(c) Skyhigh Sdn Bhd

Skyhigh will have a real property gains tax liability on the transfer of Weng Keat's plot of land to trading stock, because the taking in is deemed to be a disposal of the land. This is because the land was disposed of by Weng Keat to the company for a consideration consisting to the extent of at least 75% of shares in the company and the value at which the land was taken into trading stock exceeds Weng Keat's acquisition price plus permitted expenses.

The taking in to stock of Nancy's plot will not give rise to a deemed disposal, as it was not acquired by means of a no gain/no loss transfer.

The chargeable gain is the excess of the value at which the land was taken into stock and the amount of Weng Keat's acquisition price plus the permitted expenses incurred by him of RM5,800 (RM5,000 + RM800).

Skyhigh Sdn Bhd's liability to real property gains tax is thus:

	RM
Value at which Weng Keat's plot was taken into stock	15,000
Acquisition price plus permitted expenses of Wong Keat	(5,800)
Deemed chargeable gain	9,200
Deemed disposal date 16 April 2006	
Acquisition date 31 March 2006	
Tax at 30% (disposal within the first year of ownership)	2,760

4 (a) Advice given to **Messrs Ahmad and Ibrahim**

(i) Office equipment
The transfer of the office equipment including computers does not qualify as a controlled transfer for either partner as neither of you will have control of A&I Sdn Bhd at the time of the transfer. 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 (which are stated to be the same) and balancing charges or allowances computed accordingly. Any assets acquired by Ahmad and Ibrahim in respect of the partnership from the end of the previous basis period up to the date of the transfer will not have qualified for any capital allowances. There can be a loss of relief if such assets are transferred to A&I Sdn Bhd at a price which is less than cost.

(ii) Work in progress
As the work in progress is to be used by A&I Sdn Bhd in its business, the value on cessation of the partnership business will be equal to the value of the consideration received on transfer i.e. RM120,000.

Trade debtors
There will be no tax deduction for A&I Sdn Bhd if a loss should be incurred on the doubtful debt after it is transferred to the company. Neither will there be a tax deduction for the Ahmad and Ibrahim partnership business unless a realistic specific provision against for the loss you made in the final partnership accounts before the transfer.

Goodwill
The sale or transfer of business goodwill is a capital transaction and attracts no tax liability.

(iii) Imbalance in share consideration
There is nothing to indicate that the extra 5% is anything more than a personal gift from one partner to another. As such it would have no tax implications. A payment by way of inducement or as advance payment for services to be rendered can sometimes be taxable. However, the nature and (relatively small) size of this transaction makes such an interpretation highly unlikely.

(iv) Bank balance
Including the bank balance in the transfer has no direct tax implications but it would have been better to exclude it and so reduce the amount of paid up share capital to be issued. The reason is that a cash surplus can only be distributed by way of dividend which requires a franking balance. The equivalent amount could be made available to the company as directors' loans which can be repaid at any time without tax implications.

(v) Capital allowances
As the transfer is not a controlled transfer, the assets acquired will qualify for capital allowances, including initial allowances, at the rate appropriate to each asset, based on the cost of acquisition from the Ahmad and Ibrahim partnership, provided that they are brought into use.

(vi) Work in progress
As A&I Sdn Bhd will be paying salaries to yourselves, there is a cost attributable to any work you do for the company's clients and this should be reflected in the closing value of work in progress. Stock and work in progress must be valued at cost or market value whichever is the lower.

(b) In order to be a foreign client for the purposes of the allowance for increased exports:

(i) a company, partnership, organisation or co-operative society must be incorporated or registered outside Malaysia.

(ii) an individual must be a non-Malaysian citizen not holding a work permit or a Malaysian citizen who is a non-resident living abroad.

5 **(a)** Shiny Parts Sdn Bhd appears to be liable for prosecution for wilful evasion under section 114 of the Act as well as for making an incorrect return under section 113 of the Act.

The managing director appears to be liable for prosecution for assisting Shiny Parts Sdn Bhd in wilful evasion under section 114 of the Act as well as for making an incorrect return on behalf of Shiny Parts Sdn Bhd under section 113 of the Act.

Mr Leong may also be liable for prosecution for assisting Shiny Parts Sdn Bhd in wilful evasion under section 114 of the Act. He did act correctly and in good faith by pointing out to the managing director that not all entertainment expenses were fully deductible and that would normally excuse him from any liability. However, he should also have advised the managing director to make a written disclosure and justify his stand. Taking a different position or stand from a public ruling is a situation in which a written disclosure is required by paragraph 3.5 of Public Ruling No. 8/2000. This omission might prejudice his immunity from prosecution.

(b) **(i)** An offshore company which carries on an offshore trading activity is charged to tax on the preceding year basis by reference to the net profits shown by its audited accounts. Income from any offshore non-trading activity is also included when the company carries on both trading and non-trading activities. The chargeable profit is taxed at 3%.

(ii) Quicksale (Labuan) Limited – tax computation year of assessment 2006:

	RM
Profit before tax	1,750,000
Chargeable profits	1,750,000
Tax payable	
RM1,750,000 at 3%	52,500
Less: rebate for zakat	18,000
	34,500

(iii) Quicksale (Labuan) Limited should make the election for the company's tax for the year of assessment 2006 to be a fixed sum of RM20,000 instead of 3% of profits. The election should be made by 31 March 2006 or such extended period as may be allowed by the Director General of Inland Revenue.

(b) With regard to dividends paid by an offshore company:

(i) There is no restriction on the amount payable apart from the available profits and funds of the company.
(ii) Such a dividend is exempt from income tax.
(iii) Shareholders of a domestic company who receive such dividends are exempted from income tax.

				Marks
1	(a)	(i)	**Registered patents**	
			Relief for the cost of acquisition of proprietary rights	1
			Deduction in arriving at business adjusted income	1
			1/5th of the cost for each year of assessment	1
			Subsidiary continues to claiming based on original cost	1
			Until they have exhausted the original cost	1
			Ladang is a subsidiary of Bukit	1
			Total for (a)(i)	6
		(ii)	**Capital allowances for plant and machinery**	
			Transfers from Bukit subject to control	1.5
			Deemed acquired at residual expenditure	0.5
			No initial allowance can be claimed	1
			Annual allowances based on the original cost to Bukit	1
			Total for (b)(ii)	4
		(iii)	**Reinvestment allowance**	
			Not in operation for at least twelve months	1
			Fifteen-year qualifying period	1
			First expenditure to satisfy the requirement	1
			The company's qualifying period	1
			Grinding machine not eligible based on cost	1
			Bukit's residual expenditure	1
			New production line – RM500,000	0.5
			Grinding machine – cost RM30,000	0.5
			YA 2003 IA 20%	0.5
			YA 2003 AA 14%	0.5
			YA 2004 AA 14%	0.5
			YA 2005 AA 14%	0.5
			Set off against the statutory business income	1
			Restricted to 70% if not in a promoted area	1
			Carry forward to the following year	1
			Total for (b)(iii)	12
		(iv)	**Interest expense**	
			Employed in/held for the production of gross income	1.5
			A restriction applies	1
			Deemed monthly amount of bank interest	0.5
			Loan to Sungei outstanding at the end of each month	0.5
			Bank loan outstanding at the end of each month	0.5
			Monthly amount after restriction	0.5
			Interest deductible for the whole year	0.5
			Total for (b)(iv)	5
			Format and style	
			Appropriate style and presentation	1
			Effectiveness of communication	1
			Total for format and style	2
	(b)	**The proposed bonus issue**		
		Bonus issue of shares in not regarded as a distribution of income		1
		Funds remain with the company		1
		Company has exempt account and a section 108 balance.		1
		Balances could be passed up to the shareholders		1
		Dissipating profits constrains ability to declare dividends		1
		Propose to declare dividends first		1
		Credit dividends to account and use to subscribe for new shares		1
		Total for (b)		7
		Total for Q1		36

			Marks
2	**(a)**	**Nature of payments**	
		Franchise fee not an expense of a revenue nature	1
		Not an allowable deduction	1
		Royalty payments is tax deductible	1
		Deduct tax on paying royalties to a non-resident	1
		Franchise fee is business income	1
		No permanent establishment in Malaysia	1
		Only actual royalties which attract withholding tax	1
		Total for (a)	7
	(b)	**Income tax liability**	
		Rent	0.5
		Hire-purchase interest	1.5
		Directors fees	0.5
		Capital allowances based on	1.5
		Initial	0.5
		Annual	0.5
		Tax payable	0.5
		Estimated tax payable during the basis period	1
		Date of first payment	0.5
		Total for (b)	7
	(c)	**Tax efficiency**	
		Full tax deduction available for the rent	1
		Full tax deduction for interest payable to the bank/wife	1
		Full offset of all interest charges and capital allowances,	1
		Directors' fees	0.5
		Rent net of interest paid	1.0
		Interest from Kenneth	0.5
		Personal reliefs	0.5
		Marginal rates of tax	1
		Declare dividends to make use of the section 110 tax credit	1.5
		Tax payments up to 31 December 2007	0.5
		Tax payments due from January 2008 to May 2008	0.5
		Possible gross dividend	0.5
		Tax credit available at 28%	0.5
		Total for (c)	10
		Total for Q2	**24**

3	**(a)**	**Weng Keat**	
		No gain/no loss treatment	1
		Transfer to a company controlled by him and connected persons	1
		Consideration is at least 75% in shares	1
		Set Pew and Eng Choon are connected to Weng Keat	1
		Total for (a)	4
	(b)	**Nancy**	
		Not a no gain/no loss transfer	1
		Only connected to Eng Choon	1
		Who does not control the company as at 15 April 2006	1
		No gain/no loss disposal by husband	1
		Deemed acquisition price	1
		Disposal price	0.5
		Deemed acquisition price	0.5
		Exemption	1
		Tax at 20%	1
		Total for (b)	8

				Marks
	(c)	**Skyhigh Sdn Bhd**		
		Taking in Weng Keat's plot is deemed to be a disposal		1
		Acquired for consideration consisting at least 75% of shares		1
		Taken in at value exceeding Weng Keat's acquisition price		1
		Taking in Nancy's plot is not a deemed disposal		1
		Method of calculating chargeable gain		1.5
		Taking in value		0.5
		Acquisition price plus permitted expenses		0.5
		No exemption		0.5
		Tax at 30%		1
		Total for (c)		**8**
		Total for Q3		**20**
4	**(a)**	**(i)**	**Office equipment**	
			Does not qualify as a controlled transfer	1
			Neither partner has control	1
			Valued at the higher of the sale proceeds or their market value	1
			Balancing charges or allowances	1
			Loss of relief if assets transferred at less than cost.	1
			Total for (a)(i)	**5**
		(ii)	**Work in progress**	
			Value equal to sale consideration	1
			Trade debtors	
			No tax deduction for loss after transfer	1
			Or partnership unless a realistic specific provision is made for the loss	1
			Goodwill	
			Capital transaction attracts no tax liability	1
			Total for (a)(ii)	**4**
		(iii)	**Imbalance in share consideration**	
			Personal gift has no tax implications	1
			Inducement or advance payment for services	1
			Total for (a)(v)	**2**
		(iv)	**Bank balance**	
			No direct tax implications	1
			Better to exclude it – with reason	1
			Make it available as directors' loans	1
			Total for (a)(iv)	**3**
		(v)	**Capital allowances**	
			Not controlled transfer	1
			Capital allowances based on the cost of acquisition	1
			Total for (a)(v)	**2**
		(vi)	**Work in progress**	
			Directors' salaries should be reflected in work in progress.	1
			Lower of cost or market	1
			Total for (a)(vi)	**2**
	(b)	**Allowance for increased exports**		
		A company, partnership, etc		1
		An individual		1
		Total for (b)		**2**
		Total for Q4		**20**

			Marks
5	**(a)**	**Incorrect return**	
		Company liable for prosecution for wilful evasion	1
		Also for incorrect return	1
		Director liable for assisting in wilful evasion	1
		Also for incorrect return	1
		Accountant may be liable for prosecution for assisting	1
		Accountant acted correctly and in good faith	1
		But should also have advised disclosure	1
		Taking a different position or stand from a public ruling	1
		Might prejudice immunity from prosecution	1
		Total for 6(a)	**9**
	(b)	**(i) Basis of taxation of an offshore company**	
		Charged to tax on the preceding year basis	1
		By reference to the net profits shown by audited accounts	1
		Total for (b)(i)	**2**
		(ii) Tax liability	
		Profit before tax	0.5
		Chargeable profits	0.5
		RM1,750,000 at 3%	1
		Rebate for zakat	1
		Total for (b)(ii)	**3**
		(iii) Election	
		Election should be made for YA 2006	1
		Fixed sum tax of RM20,000	1
		By 31 March 2006 or such period allowed	1
		Total for (b)(iii)	**3**
	(c)	**Dividends**	
		No restriction on the amount payable	1
		Labuan dividend is exempt	1
		Dividends paid by a domestic company are exempt	1
		Total for (b)(iii)	**3**
		Total for Q6	**20**