



CHARTERED TAX INSTITUTE OF MALAYSIA (225750 T)  
(Institut Percukaian Malaysia)

PROFESSIONAL EXAMINATIONS

FINAL LEVEL

ADVANCE TAXATION 2

DECEMBER 2018

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Student  
Registration No.

Date

Desk No.

Examination Centre

Time allowed: 3 hours

#### INSTRUCTIONS TO CANDIDATES

1. You may answer this paper **EITHER** in English **OR** in Bahasa Malaysia. Only **ONE** language is to be used.
2. This paper consists of **SIX** questions. **Candidates are ONLY REQUIRED TO ANSWER FIVE QUESTIONS.**
3. The Income Tax Act 1967 (as amended) is referred to as ITA.
4. Each answer should begin on a separate answer booklet.
5. All workings **MUST** be shown as marks will be awarded.
6. Answers should be written in either black or blue ink.
7. No question paper or answer booklets are to be removed from the examination hall.

**DO NOT TURN OVER THIS PAGE UNTIL INSTRUCTED BY THE INVIGILATOR**

## Question 1

As the services sector contributes significantly to the economy and plays a vital role in reducing the services deficit, the government has extended tax incentives to approved service projects (ASP) with effect from YA 1996. ASP are related to transportation, communications, utilities or any other sub-sector as approved by the Minister of Finance.

### Required:

(i) List six (6) criteria which are to be considered in approving tax incentives for ASP. (3 marks)

(ii) Resident companies who undertake ASP are qualified for either income tax exemption under Section 127 of the ITA or investment allowance under Schedule 7B of the ITA.

**In your answer, state any 3 differences for each of the legislations (Section 127 and Schedule 7B ITA) mentioned above.**

(6 marks)

(iii) Carlos Sdn Bhd (CSB) just started its business operations and is principally engaged in the provision of transportation services. CSB incurred huge capital expenditures on the motor vehicles in the provision of transportation services. It is in a loss-making position.

**Assuming CSB satisfied all criteria under the ASP incentive, advise the directors of CSB on which incentive (income tax exemption under Section 127 of the ITA or investment allowance under Schedule 7B of the ITA) is more preferable.**

**State reasons to support your answer.**

(2 marks)

(iv) The investment allowance rate and the set-off given for companies undertaking ASP can be varied according to the location and types.

Discuss the variation available for the following categories:

- a. General category;
- b. Eastern Corridor of Peninsula Malaysia/East Malaysia; and
- c. Projects of national strategic importance to Malaysia.

(9 marks)

**[Total: 20 marks]**

## Question 2

- (a) Explain the importance of the income tax system from a macro perspective in Malaysia.

(10 marks)

- (b) The Malaysian Government is currently facing deficits in its annual budget partly due to the ballooning debts and the challenges in the global economy. In these difficult situations it is important for the government to continue with its fiscal policies to develop the economy.

**Required:**

**Explain how the government can alter its tax system to increase revenues without introducing new taxes.**

(10 marks)

**[Total: 20 marks]**

## Question 3

- (a) Briefly discuss the objectives of income tax audits by the Inland Revenue Board of Malaysia (IRBM), including initiatives such as the Monitoring Deliberate Tax Defaulters (MDTD) programme, in the context of the self-assessment system.

(5 marks)

- (b) Discuss briefly the two types of tax audit undertaken by the IRBM, explaining in each case the nature and objective of the audits.

(5 marks)

- (c) In selecting a company for a tax audit, discuss briefly any FOUR (4) criteria that may be used by the IRBM.

(5 marks)

- (d) Malaysia Bharu Manufacturing Sdn Bhd (the company) has been in business for several years, manufacturing microchips. The company had the following chargeable income for the years of assessment 2014 to 2017:

	YA2014	YA2015	YA2016	YA2017
Chargeable income	5,436,200	4,942,000	3,953,600	3,035,800

In March 2018 the company was audited by the officers of the IRBM. The officers informed the company that they are making the following adjustments:

- (i) Portion of the claim for capital allowance was disallowed as the IRBM was of the view the certain capital expenditure do not qualify for increased allowance;
- (ii) The donations made to a charitable body are disallowed as what was shown in the cash book and the amount stated in the official receipt do not tally; and
- (iii) The bad debt in respect of one big customer had been written off without taking 'all reasonable steps to recover the debt' and accordingly was disallowed.

Arising from the audit adjustment the revised chargeable income and the additional tax for the years of assessment 2014-2017 were as follows:

	<b>YA2014</b>	<b>YA2015</b>	<b>YA2016</b>	<b>YA2017</b>
Revised chargeable income	5,921,000	5,968,800	4,689,500	3,286,400
Additional tax	116,352.00	246,432.00	176,616.00	60,144.00

The IRBM proposed to impose a penalty of 45% on the additional tax charged.

The company was not satisfied with the audit adjustments, and has approached you for advice on the matter.

**Required:**

**With reference to the Tax Audit Framework issued by the IRBM on 1 May 2017, explain to the company how it could object to the additional tax and the penalty indicating the relevant avenues of appeal available.**

(5 marks)

**[Total: 20 marks]**

#### **Question 4**

Ruth Sdn Bhd (Ruth) is a wholly owned subsidiary of Naomi Ltd (Naomi). Ruth exports its products overseas and also to Naomi at the price of RM38 per unit, which was significantly below the price Ruth sells to all its other customers.

During a tax audit exercise, the Inland Revenue Board of Malaysia (IRBM) made an assessment against Ruth by disregarding the price it had used in its transactions with Naomi and substituted it with price similar to what Ruth had sold to other customers. The IRBM argued that the present selling price of the sales to Naomi was not set at arm's length price.

**Required**

**(i) Explain why the IRBM was allowed to make adjustments to the selling price for transactions between Ruth and Naomi and what was the rationale behind this power given to the IRBM.**

(7 marks)

**(ii) Article 9 of the OECD Model Convention and the Malaysian Transfer Pricing Guidelines have advocated the use of "arm's length method or principle". Briefly describe the arm's length principle and the guidance used by taxpayer in adopting it.**

(3 marks)

**(iii) There are five (5) transfer pricing methodologies used in determining the arm's length price. Describe briefly how each method is used.**

(10 marks)

**[Total: 20 marks]**

### Question 5

- (a) Fiscal incentives are available to a MSC Malaysia status company whose activities or products are of national and strategic importance.

**Required:**

**Briefly explain the fiscal incentives available to a MSC Malaysia status company.**

(5 marks)

- (b) The Malaysian government has expectation from MSC Malaysia status companies to provide world class information and communication technology services to facilitate the growth of multimedia technologies. Towards this end the government has provided such companies, ten (10) Bill of Guarantees to allow the companies the best possible opportunities to flourish.

**Required:**

**Briefly explain any FIVE (5) Bill of Guarantees made available by the Government of Malaysian to MSC Malaysia status companies, and the objective of each of those Bill of Guarantees.**

(10 marks)

- (c) MSC Malaysia Status companies enjoy the Bill of Guarantees provided by the government of Malaysia according to their location tiering.

**Required:**

**Explain the concept of location tiering in the context of a cybercity and cybercentres, and the Bills of Guarantees enjoyed by the relevant MSC Malaysia Status companies in these locations.**

(5 marks)

**[Total: 20 marks]**

**Question 6**

- (a) (i) **Outline the objectives, legal nature and the effect on the taxpayers from Double Tax Agreements.** (3 marks)
- (ii) **Explain the income and capital items which may be taxed without limitation in the State of source.** (3 marks)
- (iii) **State the types of income which may be subjected to “limited taxation” in the State of source.** (4 marks)
- (b) (i) **Define the concept of Residence under Article 4 of the UN Model Convention.** (2 marks)
- (ii) Paragraph 2 of Article 4 covers “dual residency” of individuals.  
**State how the residency status of an individual is determined.** (2 marks)
- (iii) **In the event, he or she is considered as dual residence in both Contracting States, what are the tie-breaker rules and tests to determine his or her residence status?** (2 marks)
- (c) Article 5 of the UN Model Convention covers the concept of “Permanent Establishment” (PE). As a legal concept, PE principle is a hybrid, a compromise between source-state taxation and residence taxation.  
**Describe the three (3) basis rules how a foreign entity can establish a PE in the other contracting state.** (4 marks)

**Note:**

Article 4 and Article 5 of the UN Model Convention are attached in the Appendix for reference.

**[Total: 20 marks]**

**(END OF QUESTION PAPER)**

**UN Model Convention**

## Article 4

## RESIDENT

1. For the purposes of this Convention, the term “resident of a Contracting State” means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of incorporation, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.
2. Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then his status shall be determined as follows:
  - (a) He shall be deemed to be a resident only of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident only of the State with which his personal and economic relations are closer (centre of vital interests);
  - (b) If the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident only of the State in which he has an habitual abode;
  - (c) If he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident only of the State of which he is a national;
  - (d) If he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.
3. Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident only of the State in which its place of effective management is situated.

## Article 5

### PERMANENT ESTABLISHMENT

1. For the purposes of this Convention, the term “permanent establishment” means a fixed place of business through which the business of an enterprise is wholly or partly carried on.
2. The term “permanent establishment” includes especially:
  - (a) A place of management;
  - (b) A branch;
  - (c) An office;
  - (d) A factory;
  - (e) A workshop;
  - (f) A mine, an oil or gas well, a quarry or any other place of extraction of natural resources.
3. The term “permanent establishment” also encompasses:
  - (a) A building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than six months;
  - (b) The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than 183 days in any 12-month period commencing or ending in the fiscal year concerned.
4. Notwithstanding the preceding provisions of this Article, the term “permanent establishment” shall be deemed not to include:
  - (a) The use of facilities solely for the purpose of storage or display of goods or merchandise belonging to the enterprise;
  - (b) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage or display;
  - (c) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
  - (d) The maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;
  - (e) The maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character.
  - (f) The maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs (a) to (e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.



5. Notwithstanding the provisions of paragraphs 1 and 2, where a person—other than an agent of an independent status to whom paragraph 7 applies—is acting in a Contracting State on behalf of an enterprise of the other Contracting State, that enterprise shall be deemed to have a permanent establishment in the first-mentioned Contracting State in respect of any activities which that person undertakes for the enterprise, if such a person:
  - (a) Has and habitually exercises in that State an authority to conclude contracts in the name of the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph; or
  - (b) Has no such authority, but habitually maintains in the first-mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise.
6. Notwithstanding the preceding provisions of this Article, an insurance enterprise of a Contracting State shall, except in regard to re-insurance, be deemed to have a permanent establishment in the other Contracting State if it collects premiums in the territory of that other State or insures risks situated therein through a person other than an agent of an independent status to whom paragraph 7 applies.
7. An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business. However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise, and conditions are made or imposed between that enterprise and the agent in their commercial and financial relations which differ from those which would have been made between independent enterprises, he will not be considered an agent of an independent status within the meaning of this paragraph.
8. The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.