

TAXATION**QUESTION 1(a)**

Ah Tong is not correct in his approach to the matter of the taxability of the income from operating the bus.

The Income Tax Act 1967 (as amended) defines 'business' to include a profession, vocation, and trade and every manufacture, adventure or concern in the nature of trade, but excludes employment.

The definition does not rule out any illegal activities as not falling within the meaning of trade, or adventure in the nature of trade. Therefore, once it is established that the transaction or activity is in the nature of a trade or adventure in the nature of trade, then it follows that any gains that arises from such activities would fall within the meaning of section 4(a) which provides that 'gains or profits from a business for whatever period of time carried on' would be chargeable to tax.

There are several case laws that support this approach:

1 In the case of *Partridge v Mallandaine* (2 TC 179) the courts held that the gain from the illegal activities is liable to tax. In this case, two persons attended race courses as book makers on horse racing and made profits from the habitual betting on horses. The taxpayers argued that they are not carrying on any business, and even if they do, it was illegal and therefore the income derived therefrom is not liable to tax. In determining that what is being done is the carrying on of a trade, Denman J said:

'...in my opinion, if a man carried on a systematic business of receiving stolen goods and made by it £2,000 a year, the Income Tax Commissioners would be right in assessing him thereon'.

2 In the case of *Mann v Nash* (16 TC 523), profits derived from the use of gaming machines, some of which were illegal for public use, it was held that the income derived is taxable since the income is derived from the carrying on of a business.

3 In the case of *Southern v AB* (18 TC), the profits of a bookmaker derived solely from betting which were under the relevant law at that time, illegal, were held to be assessable to income tax.

Ah Tong should therefore declare the income since it was derived from the carrying on of a business of providing transport services – the fact that the business is operated without a license, permit or is illegal is not an issue.

(5 marks)

QUESTION 1(b)

	Note	Add (+) RM 000	Ded (-) RM 000	RM 000
Net profit as per Profit and Loss account				√ 151,461
Less: Cost of goods sold	1	√ 10909		
Rental income	2		√ 65000	
Advertisement	3			
Staff recruitment etc		Nil		
Condolence message and wedding announcement (RM 20,000 x 2)		√ 40		
Cash donation for school library		√ 50		
Contribution to 'Save the Trees'		√ NA		
Bad and doubtful debts	4			
Increase in general provision		√24		
Recovery			√100	
Depreciation		√ 300		
Donation	5	√400		
Entertainment	6			
Cost of ink cartridges		√ NA		
Annual dinner		√ NA		
Refreshment for staff		√ NA		
Disbursement of entertainment expenses		√ 230		
Fines and penalties	7			
Late payment to the IRB		√ 2		
Penalty on late contribution to EPF		√ 3		
Fines and compound for traffic offences		√ 9		
Insurance	8		√ 10	
Lease charges		nil		
Repairs and maintenance	9			
Replacing broken main glass door		√ NA		
Replacing security alarm system		√ 5		
Replacement of office clocks and calculators		√ 8		
Professional fees				
Statutory audit fees	10	nil		
Due diligence audit fee		√ 10		
Efficiency study		√ 3		
Secretarial fees		√ 6		
Registration of a patent		√ 5		
Legal fee for dismissal of employee		√ NA		
Tax audit appeal		√ 5		

ii) Explanatory notes	points
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Consultant fee for market expansion		√ NA		
Recovery of loan debt		√ 2		
Remuneration	11			
Employment of disabled employee			√ 24	
EPF contribution (restricted to 19%)		√ 2		
Staff welfare	12			
Broadband subscription		√ NA		
Salaries of maid and tuition teachers		√ NA		
Repairs of childcare centre upon purchase		√ 150		
Royalty and commission	13			
Royalty		/NA		
Commission (Capital)		√ 5		
		√ 12168	√ 65134	√ 151461
				√ 12168
				√ 162639
				√ (65134)
Adjusted income from business				√ 98495
Add: Balancing charge				√ 20
Less:				√ 98515
Capital allowance			√ 150	
Balancing allowance			√ 30	√ (180)
Statutory income from business				98335
Less: Unabsorbed loss b/f				√ 40
Rental income - exempt				Nil
Aggregate income				√ 98295
Less; Cash gift and donation (limit 10%)				√√ 130
				98165
Less: Contribution in kind to an approved sports activity				√ 70
Total income /chargeable income				√ 98095

(60 √ = 10 marks)

Note 2: Other income The rental income is from a non-business source income to be dealt with separately as income falling under section 4(d) ✓	1
Note 3: Advertisement Advertisements pertaining to staff and workers recruitment are expenditure incurred wholly and excusably in the production of gross income - sec 33 ✓	1
The condolence message is not incurred wholly and exclusively in the production of gross income and is to be disallowed - sec 39 ✓	1
The cash donation to the government aided school is allowable under sec 34(6) (g) subjects to maximum of RM 100,000. The balance of RM 50,000 should be added back: Proviso to sec 34(6) (g). ✓✓✓	3
The contribution to the organization towards their 'Save the Trees' program would qualify for deduction under sec 34(6)(h). ✓✓	2
Note 4: Bad and doubtful debts From the opening balance the general debts will be allowed and the specific provision would be disallowed while from the closing balance, the closing general balance would be disallowed and the specific provision would be allowed. The amount written off is an allowable outgoing. ✓✓✓✓✓	5
As for the recoveries, the sum of RM 100,000 would be excluded from charge as it refers to a capital recovery. ✓ Law: Sec 34 and 39	1
Note 5: Donations ✓ The cash donation of RM 60,000 will be disallowed (sec 39) in determining the statutory income and allowed under section 44(6) to arrive at the aggregate income. ✓	1
The sports equipment worth RM 70,000 is a donation in kind. It would be disallowed in determining the statutory income from business (sec 39) but would qualify for a under section 44(11B). ✓✓	2
Note 6: Entertainment ✓ The cost of the ink cartridges given away is part of the sales promotion costs - incurred wholly and exclusively in the production of gross income ✓	1
The annual dinner of RM 10,000 is incurred wholly and exclusively in the production of gross income - sec 39(1) (l) (vii) ✓	1
The refreshment and snacks provided to the staff is fully deductible. Hence no adjustment [allowable under sec 39(l)(i)]. ✓	1
50% of the amount incurred to disburse the entertainment expenditure of the sales and marketing staff would be disallowed – section 39(1)(l). ✓	1
Note 7: Fines and penalties ✓ The penalty paid to the Inland Revenue Board is not incurred wholly and exclusively in the production of gross income - sec 39 ✓	1
The penalty paid to the EPF is also not incurred wholly and exclusively in the production of gross income and is disallowed- sec 39 ✓	1

The penalties and fines for the traffic offences are also not incurred wholly and exclusively in the production of gross income and therefore disallowable. - Sec 39 ✓	1
Note 8: Insurance Amount qualifies for double deduction (IT (Ded. of insurance premium for exporters) Rules 1995 ✓✓	1
Note 9 Repairs and maintenance Replacing the glass door to the office entrance is a revenue expenditure and would qualify for a deduction – sec 33 ✓ ✓	1
Replacement of the security alarm system with an improved and upgraded version is a capital expenditure and is disallowed under sec 39 ✓	1
The replacement of the several office clocks and the calculators would be allowed to a maximum of RM 10,000 - the balance will be disallowed (Para 19A (1) Sch 3) ✓✓	2
Note 10: Professional fees There is no adjustment for the statutory audit fee since the expenditure is allowed under IT (Deduction for Audit Expenditure) Rules 2006 ✓✓	2
The due diligence audit fee is connected with intended acquisition of another company and is a capital expenditure disallowed under sec 39 ✓	1
The efficiency study on the product distribution is an outgoing incurred in the course of carrying on a business. It is allowable under section 33 and no adjustments are required. ✓	1
The secretarial fees are specifically disallowable under Public Ruling 6 of 2006 ✓	1
Registration of a patent is a capital expenditure and is disallowed. ✓	1
The legal fee for the dismissal of an employee is an outgoing and is allowable - Case law: Mitchell v BW Noble ✓✓	2
Accounting fees for tax appeal do not qualify for deduction. Case law: Smith's Potato Estate; Allen v Farquharson Brothers. ✓✓	2
The consultant fee for the market expansion is a revenue outgoing, incurred in the in the course of business - allowable under section 33. ✓	1
The legal fee for the recovery of the debts from the dismissed director is capital related expenditure - not deductible. ✓	1
Note 11: Remuneration The remuneration paid to the disabled employee qualifies for double deduction under the Income Tax (Deduction for employment of disabled persons) Rules 1982 ✓✓	2
The contribution made to the EPF is allowed a maximum of 19% of the remuneration of the employee i.e. RM 11,400. The excess exceeding 19% of the remuneration i.e. RM 600 would be disallowed - sec 34(4) ✓✓	2
Note 12: Staff welfare The subscription to the broadband service is fully allowed - IT (Deduction for gifts of New Computer and Monthly Broadband Subscription Fee to Employees) Rules 2008 ✓✓	2
No adjustment for the salaries paid for the maids and the tuition teachers - allowed under sec 34(6) (i) ✓✓	2

The cost of the repairs immediately upon purchase of the building would not qualify since it is deemed to be a capital expenditure - Case law: Law Shipping Co. However capital allowance is on the cost of the building and the repairs disallowed, under Para 42A (2) Sch 3	√√√	3
Note 13: Royalty and commission No adjustment - the penalty due to the Inland Revenue Board is disallowed in adjusting the Fines and Penalty Account	√	1
Withholdings tax is applicable to the sum remitted to the merchant in the Philippines. As the withholding taxes have not been withheld, the total expenditure would be disallowed on account of the non-compliance. Law: sec 4(f), 15B, 39(1) (j) and 109F	√√√√	3
		60 pts = 10 marks

(Total : 25 marks)

QUESTION 2(a)

Under Para 14 of Sch 3 of the Income Tax Act 1967 (as amended) an allowance known as the annual allowance would be given under Para 15 to 16A if the following conditions are satisfied:

- A person has for the purposes of a business of his incurred qualifying plant expenditure in relation to an asset;
- At the end of the basis period for a year of assessment he was the owner of the asset ;
- And it was in use for the purpose of the business.

A person shall not be entitled to an allowance under the schedule for a year of assessment unless he makes a claim for the allowance for that year of assessment in accordance with Para 77 under which, in making the claim, he shall make a written statement containing such particulars as may be required to show that the claimant is entitled to the allowance and a certificate signed by the claimant verifying those particulars. The claim must then be furnished with the return of his income under section 77 or 77A for that year.

(2 marks)

QUESTION 2(b)**(i) Plant and machinery**

Cost of plant and machinery		√ 162000
Add: Installation cost (see note below)		√ 56000
Qualifying expenditure		218000

Year of assessment 2009

Initial allowance	20%	√	43600
Annual allowance	14%	√	30520
	Residual expenditure c/f		143880

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Note: The cost of the installation qualifies as part of the cost of the plant and is not restricted since the alteration is to the building and not land.

[Para 2((1)(a) Sch 3 Income Tax Act 1967 (as amended)]

(ii) Extension of showroom

The expenditure will not qualify for any capital allowance since it is neither plant and machinery or industrial building. ✓

(iii) Furniture and fittings

Cost		✓ 27000
Year of assessment 2009		
Initial allowance	20%	✓ 5400
Annual allowance	10%	✓ 2700
Residual expenditure c/f		<u>✓ 8100</u> <u>18900</u>

(iv) Mini lorry

Cost of mini lorry		✓ 149000
Less: down payment		✓ 80000
Balance financed by loan		<u>✓ 69000</u>

Capital portion of installment payment	69,000 /30	<u>✓✓✓ 2300</u>
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Qualifying expenditure		
Down payment		✓ 80000
Installment payments	3 mths x RM 2,300	✓ ✓ ✓ 6900
		<u>✓ 86900</u>

Year of assessment 2009		
Initial allowance	20%	✓ 17380
Annual allowance	20%	✓ 17380
Residual expenditure c/f		<u>✓ 34760</u> <u>✓ 52140</u>

(v) Motor car

Cost of motor car		<u>✓ 160000</u>
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Qualifying expenditure restricted to max (see note below)		√ 50000
Year of assessment 2009		
Initial allowance 20%		√ 10000
Annual allowance 20%		√ √ 0
		√ 40000
Less: Disposal RM 128,000 x RM 50,000 / RM 160,000		<u>√√√√/40000</u>
Balancing allowance/charge		<u>√ 0</u>

Note:

(1) As the car was purchased after 28 Oct 2000 and the cost of the vehicle is more than RM 150,000 the maximum qualifying capital expenditure would be restricted to RM 50,000. [Proviso to Para 2(2) Sch 3] √ √

(2) The company would not qualify for the annual allowance since it was not in use at the end of the relevant basis period for the year of assessment [Para 15 Sch 3] √ √

(3) The recovered expenditure would be restricted to a proportion of the qualifying expenditure in relation to the cost of the motor vehicle. [Para 62(2) Sch3] √ √

(37 √ = 10 marks)
(Total : 12 marks)

QUESTION 3(a)

(i) 5% Method		RM
Gross income derived from outwards shipping from Malaysia		√ 9,984,0000
Deemed statutory income		
5% of gross income from outward shipping from Malaysia		√ 4,992,0000
Less: Donation to approved institution (Max: 10% of agg)		<u>√ 9,100</u>
Chargeable income		<u>√ 4,991,0900</u>
Tax charged		
25% of 49,910,900		√ 12477725

(ii) Acceptable certificates method			
Adjusted income	19,968,000 x [99,840,000/232,960,000]	8,557,714	√√√√√
Less: Capital allowance	16,640,000 x [99,840,000/232,960,000]	<u>7,131,429</u>	√√√√√
Statutory income		1,426,286	√
Less: Approved donation		<u>9,100</u>	√√
Chargeable income		<u>1,417,186</u>	√

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Tax charged

25% of 1,417,186

354,296.43 ✓✓

(✓ 21 pts = 10 marks)

QUESTION 3(b)

Under section 54(5), the DGIR would accept a certificate as an 'acceptable certificate' if he is satisfied that the amount specified in the certificate has been computed by methods not substantially different from those provided by the Income Tax Act 1967 (as amended) for the computation of analogous figures for a similar business carried on by the person who is a resident.

The certificate must be one issued by the authority responsible for the administration of the tax laws of any country in which the operator is resident for the purposes of those laws. The certificate must specify in respect of the business for the relevant period the amount of the gross income from wherever derived, the income or loss computed for the purposes of the foreign tax by that authority without making any allowance for depreciation, and the total depreciation allowance given by that authority excluding any allowance or part thereof brought forward from a previous period.

Such a certificate must be furnished to the Director General of Inland Revenue in Malaysia within three years or such further period as the DGIR may allow after the commencement of the relevant year.

Generally Malaysia accepts the certificate issued by countries with which it has a double tax agreement.

(3 marks)

(Total : 13 marks)

QUESTION 4

a)

Territorial or Territorial Basis:

The taxpayer is chargeable only on income accrued in or derived from Malaysia /. Foreign income that is remitted is taxable but is exempted under para 27 Schedule 6/. This principle is apply to all taxpayers (such as individuals, company, trust body and body of persons) irrespective whether they are resident or not in Malaysia.

Derived and Remittance or Modified Territorial Basis:

This scope of charge only applies to non-business income of resident persons carrying on specialized businesses such as banking, insurance, sea and air transport business /. Foreign income from non-business sources (such as dividends, rent and interest) are chargeable to tax upon remittance into Malaysia /.

World Income Basis

Under Section 60C of ITA, 1967, income from business sources of specialized industries such as banking, insurance, sea and air transport resident in Malaysia are chargeable to tax on a world scope basis. That is, taxpayers are chargeable to tax on the business income from wherever derived /, irrespective whether the income is remitted to Malaysia or not /. Other income from non-business sources such as dividends, rent and non-banking business are subject to tax on a modified territorial basis i.e. derived and remittance basis. However, the income of the non-resident banks and financial institutions, insurance, shipping and airlines operators are subject to tax on a territorial basis.

(6 / x 1 = 6 marks)

b) Principle of taxation

Equity

Equity is the most important principle in any tax system. It refers to taxes being imposed equally and fairly on all taxpayers /. A tax system should not impose radically different tax burdens on taxpayers with similar abilities to pay /. The tax system should ensure that each corporation pays a fair share of tax in relation to their commercial profits /. However, certain tax provisions allow certain taxpayers to pay relatively less income taxes /.

Neutrality

The effect of tax laws on taxpayers' decisions on how to carry out a particular transaction or to engage in any activity should be kept to a minimum /. Taxpayers should not be unduly encouraged or discouraged from engaging in certain activities /. The main objective of the tax system is to raise revenue, not to change behavior. A tax is levied in a neutral way if there is no significant difference in effective taxation between different categories of firms /. An ideal business tax system would be neutral with respect to different industries, asset types, and degrees of risk. Thus, the non-neutrality of a tax system refers to possible differences in effective treatment across different sectors or sizes of firms /. Thus, providing tax incentives to specific industries could possibly lead to the non-neutrality of the tax system /. Therefore, if the tax incentives are not properly structured, it could lead to an unbalanced distribution of economic activities which could be harmful to the country.

(10/ x ½ = 5 marks)

c) Advantages of GST:

- (i) A broad based robust tax which would increase the tax revenue in the future /.
- (ii) Could reduce the income tax rate for company as well as individual taxpayers so that the income tax system becomes more competitive /.
- (iii) GST is a multistage concept of indirect tax, thus should be able to speed up the collection of tax revenue for the government /.
- (iv) Avoid cascading effect prevalent under existing sales tax and service tax.
- (v) Under GST, there is an audit trail thereby improving ability to detect non-compliance

(1/ x 1 mark = 3 marks)

(Any three answers)

(Total: 14 marks)

QUESTION 5

i) Computation of chargeable income and exempt income

YA 2009	New Project RM	Present Business RM	Total RM
Adjusted income	-	4,000,000 /	
Capital allowance: Current Year Brought forward	- c/f 40,000 /	(500,000) / -	
Statutory income	-	3,500,000	
Exemption	-	-	
Statutory income after exemption	-	3,500,000	3,500,000
Dividend			Exempt /
Aggregate income			3,500,000
Adjusted loss			(300,000) /
Chargeable income			3,200,000 /
Exempt income			- /
Unabsorbed ITA c/f	60,000 /		-

YA 2010	New Project RM	Present Business RM	Total RM
Adjusted income	900,000 /	6,000,000 /	
Capital allowance: Current Year Brought forward	(120,000) / (40,000) /	(350,000) / -	
Statutory income	740,000	5,650,000	
Exemption	(180,000) //	-	
Statutory income	560,000	5,650,000	6,210,000
Interest			20,000 /
Adjusted loss			-
Aggregate income			6,230,000
Chargeable income			6,230,000 /
Exempt income			180,000

Workings on capital allowance:

	Machine I	Machine II	Motor Vehicle	Total
YA 2009				
QPE	100,000			
IA 20%	(20,000)			
AA	(20,000)			40,000
YA 2010				
QCE		200,000	50,000 (restricted)	
IA 20%		(40,000)	(10,000)	
AA	(20,000)	(40,000)	(10,000)	120,000

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Workings on Investment Tax allowance:

	2009	2010
ITA c/f	-	60,000
60% x QPE /	60,000 /	120,000 /
ITA available	60,000	180,000
70% x Statutory income /	-	630,000
ITA absorbed	-	180,000
ITA c/f	60,000	-

(20 / x ½ = 10 marks)

ii) Criteria to be eligible for reinvestment allowance:

- The company is resident in Malaysia /
- The company was incorporated since 2005 i.e. more than 3 years /
- The company had incurred capital expenditure / for a new project which was related to an expansion of the present business activity /

(1 / x ½ = 2 marks)

iii) Computation of withholding tax:

Gross amount of rent 36,000 charged as an expense / in the book of Jati Wood Sdn Bhd
 Less 10% / wht S.4A (3,600) /
 Net payment to NR 32,400 /

Penalty for non-compliance i.e. failure to submit the withholding tax by 30 April 2009, Jati Wood Sdn Bhd will be subject to a penalty of 10% / of withholding tax i.e. RM360 and the gross amount of rent RM36,000 becomes a disallowable expense / until the penalty has been paid to IRB.

(6 / x ½ = 3 marks)

(Total: 15 marks)

QUESTION 6

i) Statutory income of Azman for the year of assessment 2009

S.13(1)(a)					
Salary	15,000 x 12		180,000	/	
Entertainment allowance	5,000 x 12		60,000	/	
Servant	650 x 12		7,800	/	
Tuition fees	350 x 12		4,200	/	252,000
S.13(1)(b)					
Furniture			3,360	/	
Corporate membership	Entrance fee		exempted	/	
	subscription		3,600	/	
Mobile phone	Hardware		exempt	/	
	Bills		exempt	/	
Driver	600 x 12		7,200	/	
Car			7,000	/	
Fuel			1,800	/	
Holiday - Australia	Air tickets		5,000	/	

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	Meals		4,000	/		
	Accommodation		5,000	/		
Medical expenses			exempted	/	36,960	
S.13(1)(c)						
Living accommodation	Defined value		32,800	/		
	30% x 13(1)(a)		75,600	/	32,800	/
Gross income					321,760	
Entertainment expenses					(60,000)	//
Adjusted/statutory income					261,760	

(21/ x 1/3 = 7 marks)

ii) Basis periods for the partnership business for years of assessment 2008 and 2009.

YA	Aisya	Sister	Cousin
2008	1.1.2008 – 31.12.2008 /	1.1.2008 – 31.3.2008 /	1.4.2008 – 31.12.2008 /
2009	1.1.2009 – 31.12.2009 /	- /	1.1.2009 – 31.12.2009 /

(6/ x 1/3 = 2 marks)

iii) Computation of adjusted income and the statutory income for Aisya, her sister and her cousin for the years of assessment 2008 and 2009.

Accounting period: 1.1.2008 – 31.3.2008

Partners	Salary RM	Interest RM	Divisible Income	Adjusted Income
Aisya	21,000	2,500	(1,600)	21,900 /
Sister	18,000	1,750	(800)	18,950 /
	39,000	4,250	(2,400)	40,850

Accounting period: 1.4.2008 – 31.12.2008

Partners	Salary RM	Interest RM	Divisible Income	Adjusted Income
Aisya	72,000	7,500	1,700	81,200 /
Cousin	72,000	7,500	1,700	81,200 /
	144,000	15,000	3,400	162,400

Accounting period: 1.1.2009 – 31.12.2009

Partners	Salary RM	Interest RM	Divisible Income	Adjusted Income
Aisya	96,000	10,000	24,000	130,000 /
Cousin	96,000	10,000	24,000	130,000 /
	192,000	20,000	48,000	260,000

	Aisya	Sister	Cousin
YA 2008			
Adjusted income	103,100	18,950	81,200
Capital allowance	(30,000) /	-	(30,000) /
Statutory income	73,100 /	18,950 /	51,200 /
YA 2009			
Adjusted income	130,000	-	130,000
Capital allowance	(52,500) /	-	(52,500) /
Statutory income	77,500 /	-	77,500 /

(15 / x 1/3 = 5 marks)

- iv. Computation of income tax liabilities of Azman and Aisya for the year of assessment 2009.

	Azman		Aisya	
Sec. 4(a) Business			77,500	/
Sec. 4(b) Employment	261,760	/		
Aggregate income	261,760		77,500	
Donation			(5,425) max. 7% of Agg income	//
Total income	261,760		72,075	
Personal relief:				
Self	(8,000)	/	(8,000)	/
Books	(1,000)	/		
Basic supporting equipment			(5,000)	/
Medical expenses - parents	(4,800)	/		
Children (3 x 1000)	(3,000)	/		
EPF / life insurance premium	(6,000)	/	(4,800)	/
Medical and education insurance premiums			(3,000)	/
Chargeable income /	238,960		51,275	
Tax at scale rate:				
1 st 100,000 / 1 st 50,000	14,325.00	/	3,325.00	/
Next 138,960 x 27% / Next 1,275 x 19%	37,519.20		242.25	
Tax payable	51,844.20	/	3,567.25	/
Zakat	(9,000)	/	-	
Net tax payable	42,844.20	/	3,567.25	/

(21 / x 1/3 = 7 marks)
(Total: 21 marks)