



# **ACCA ADVANCED TAXATION MALAYSIA ERRATA SHEET**

## **PRACTICE & REVISION KIT (EXAMS DEC21, MAR22, JUN22, DEC22)**

**FEBRUARY 2022**

### **Answers to Mock Exam 3 (p363–374)**

The answers to Mock Exam 3 are incorrect. The correct answers have been provided in the following pages.

# SECTION A

## Question 1

### Marking scheme

### Marks

(a) <b>New plantation and railway system</b>			
(i) <b>Agriculture allowances</b>			
Eligibility	$0.5 \times 5$		2.5
Computation	$0.5 \times 4$		2
<b>Available</b>			<u>4.5</u>
<b>Maximum</b>			<u>4</u>
(ii) <b>Railway track allowances</b>			
Why 'plant' – functional test, enduring advantage, permanent use,			
non-current asset	$0.5 \times 4$		2
Qualify for CA, incurred, owned, in use in business	$0.5 \times 3$		1.5
CA computation			1.5
<b>Available</b>			<u>5</u>
<b>Maximum</b>			<u>4</u>
(b) <b>Research and development (R&amp;D) expenditure</b>			
Qualifies for single deduction: reasons			1 + 1
Amortised amount not deductible			1
Entire sum deductible, tax adjustment			<u>1 + 1</u>
<b>Available</b>			<u>5</u>
<b>Maximum</b>			<u>4</u>
(c) <b>Tax computation for YA 2021</b>			
Gain on disposal of non-current assets			0.5
Amortised amount added back			0.5
Depreciation			0.5
Donations disallowed			0.5
Legal and professional fees disallowed			1
R&D expenditure allowed in full			0.5
Balancing charge			1
CA			$0.5 + 0.5$
Agriculture allowance			0.5
Approved donation in cash, correct amount			$0.5 + 0.5$
Donation restricted to 10% of aggregate income			0.5
Application of correct tax rate			<u>0.5</u>
			<u>8</u>
(d) <b>Tax estimate for YA 2022</b>			
Excessive difference, 30% buffer, penalty			$0.5 + 0.5 + 0.5$
Deadlines for revision			$0.5 + 0.5$
Minimum amount of additional estimate			1
<b>Available</b>			<u>3.5</u>
<b>Maximum</b>			<u>3</u>

(e)	<b>Freight charges</b>		
(i)	Tax treatment of Labuan company	1 + 0.5 + 1 + 0.5 + 0.5 + 1 + 0.5 + 0.5	
	<b>Available</b>		<u>5.5</u>
	<b>Maximum</b>		<u>4</u>
(ii)	Deduction restricted for resident payer		<u>1</u>
(f)	<b>Replanting contract</b>		
(i)	Deductibility of replanting		1
(ii)	Transfer pricing issue	1.5 + 1	2.5
	Recommendation		<u>1</u>
	<b>Available</b>		<b>3.5</b>
	<b>Maximum</b>		<b>2</b>
	Professional marks Format and presentation of the letter		1
	Clarity and effectiveness of communication including logical flow		2
	Appropriate use of appendix		<u>1</u>
			<u>4</u>
			<u>35</u>

# 1 Report to Mr Chia of Alpha Beta Sdn Bhd

**Date** 8 December 2021

**From** Tax associate, Tax Firm

**To** Mr Chia, finance director, Alpha Beta Sdn Bhd

**Subject:** Responses to tax issues raised

We refer to our meeting on 29 November 2021 regarding the capital expenditure in the past year and plans in the immediate future.

This report will highlight the main tax issues for ABSB. We also attach a draft tax computation for the year of assessment (YA) 2021 to demonstrate their impact.

## (a) New plantation land and railway system

### (i) Plantation expenditure

ABSB is eligible to claim agriculture allowances as the company fulfils the following conditions:

- (1) ABSB is in the business of working a plantation
- (2) It has incurred qualifying agriculture expenditure on new planting, roads, bridges, buildings used in business and for workers' accommodation
- (3) ABSB is the owner of the assets and the assets are in use for the plantation during and at the end of the basis period for YA 2021

The computation of the agriculture allowances for YA 2021 is as follows:

	Qualifying agriculture expenditure	Rate	Allowance
	RM'000	%	RM'000
New planting	4,800	50	2,400
Roads and bridges	1,200	50	600
Workers' accommodation	560	20	112
Storage buildings	930	10	<u>93</u>
Total			<u>3,205</u>

### (ii) Railway track system

The expenditure on the railway track system is capital in nature as it brings into existence an asset of enduring advantage for use in the business, and the asset is for permanent employment in the business. It is therefore fixed capital rather than circulating capital.

Plant as defined under the Income Tax Act 1967 as:

'an apparatus used by a person for carrying on his business but does not include a building, an intangible asset, or any asset used and that functions as a place within which a business is carried on.'

The railway track system performs an active function rather than merely provides a business setting which is 'plant' for capital allowances purposes. ABSB qualifies for capital allowances because the company incurred the qualifying plant expenditure, is the owner, and used the asset in the business during and at the end of the basis period.

The computation of capital allowances for the railway tracks is as follows:

	RM'000	RM'000
Qualifying plant expenditure		<u>6,000</u>
Initial allowance at 20%	1,200	
Annual allowance at 14%	<u>840</u>	
	<u>2,040</u>	

(b) **Research and development (R&D) expenditure**

The R&D expenditure incurred of RM1,450,000 is to develop high-yielding seedlings for its own planting. Hence it is directly related to its business. In view of the fact that ABSB will not be applying for any tax incentives for R&D expenditure, the amount qualifies for a single tax deduction as it is specifically provided for under section 34 of the Income Tax Act 1967 (ITA 1967).

For accounting purposes, the R&D expenditure has been capitalised and amortised over five years. Therefore, the amortised amount of RM290,000 charged to the statement of profit or loss should be disallowed, because the amount was not the actual sum incurred, but merely an amortised amount. Another adjustment should be made in the tax computation to deduct the entire sum of RM1,450,000 as the expenditure was incurred in YA 2021.

(c) **Tax computation for Y/A 2021**

The attached appendix shows the tax computation of ABSB with a chargeable income of RM33,642,000. Tax payable for Y/A 2021 would be RM8,074,080.

(d) **Tax estimate for YA 2022**

With the enlarged plantation operations, the estimated tax for YA 2022 has increased to RM30 million from the original estimate of RM18 million. As the final tax liability exceeds the estimated tax or revised estimated tax by more than 30%, a penalty imposable of 10% on the amount in excess of the 30% buffer.

ABSB has until 31 March 2022 (the end of the sixth month of the basis period) or 30 June 2022 (the end of the ninth month of the basis period) to submit a revised tax estimate (Form e-CP204A) by e-filing. Revision by either deadline is permissible in law. An earlier revision or later revision may be selected depending on the cash flow position of ABSB.

The minimum additional amount by which ABSB must revise its estimate to avoid incurring a penalty is:

	RM'000
Final tax liability	30,000
30% thereof	<u>(9,000)</u>
Minimum amount of revised tax estimate	21,000
Original estimate	<u>(18,000)</u>
Minimum additional tax estimate	<u>3,000</u>

(e) **Freight charges**

(i) Below is a summary of the tax treatment of a company under the Labuan tax regime:

- A Labuan company is carrying on a Labuan business activity is required to fulfil substance requirements in the form of the prescribed minimum number of full-time employees in Labuan, and the minimum amount of annual operating expenditure in Labuan
- A Labuan company is taxable only on income from trading activities, which include shipping activity
- The chargeable profit of the Labuan company from its trading activity, which is the net profit as per the audited financial statements, is subject to tax at 3% provided the it fulfils the substantive requirements. This is highly preferential when compared to the standard rate of 24% for companies under the ITA 1967
- If a Labuan company failed to fulfil the substance requirements, the chargeable profit would be taxed at 24% instead of 3%
- However, any royalty and any income from intellectual property received by a Labuan company will be taxable under the ITA 1967
- It is taxable on the preceding year basis, rather than the current year basis
- Where it is deemed preferable to avail itself of the treaty benefits under double taxation agreements entered into by Malaysia, a Labuan company may make an irrevocable election to be treated under the ITA 1967
- A Labuan company is exempted from stamp duty, sales tax, service tax
- It is also exempted from withholding tax when it makes payments to non-residents

(ii) However, it is important to note that the tax deduction for any payment made by ABSB, a resident company, to the Labuan entity which include a Labuan company for shipping agriculture produce, will be restricted to 3% of the total payment made. This means that 97% of any such payments will be disallowed to ABSB.

(f) **Replanting contract**

- (i) Replanting is specifically allowable as a deduction in ascertaining adjusted income for income tax purposes under Section 34 ITA 1967.
- (ii) The proposed out-sourcing contract to its subsidiary for replanting ABSB's acreage is a transaction between two related parties because the subsidiary is controlled by ABSB.

The fee is set at 15% above the prevailing market rate to help boost the subsidiary's profitability. This is therefore not a transaction at market value between two independent parties.

This arrangement will likely contravene the arm's length principle expounded under Malaysia's transfer pricing (TP) regulations.

A recommended best-practice measure will be for ABSB to have TP documentation on the value adopted for the transactions between related parties. This is for ABSB to conduct a bench-mark exercise to determine the fair market rate for the replanting activity and then base the value of its contract with its subsidiary accordingly. This will comply with the TP regulations and avoid any penalties imposable on TP adjustments.

The Director General of Inland Revenue (DGIR) have been focusing on TP transactions recently during their tax audit on taxpayers. It is an offence if a taxpayer is unable to produce the contemporaneous TP documentation within 14 days from the date requested by the DGIR. Penalty or fine on conviction can be imposed.

– End of report

## Appendix

### Alpha Beta Sdn Bhd

#### Tax computation for YA 2021

	RM'000	RM'000
Profit before tax		37,000
Less: Gain on disposal of non-current assets		<u>(380)</u>
		36,620
Add: Amortised R&D expenditure	290	
Depreciation	469	
Donations	5,800	
Legal and professional fees	<u>451</u>	
		7,010
Less: R&D expenditure		<u>(1,450)</u>
Adjusted income		42,180
Add: Balancing charge		<u>920</u>
		43,100
Less: Capital allowances		
Railway tracks	2,040	
Other assets	475	
Agriculture allowances	<u>3,205</u>	
		<u>(5,720)</u>
Statutory income/aggregate income		37,380
Less: Cash donation of RM 5 million, restricted to 10% of aggregate income		<u>(3,780)</u>
Total income chargeable income		<u>33,642</u>
Income tax at 24%		RM8,074,080

## Question 2

### Marking scheme

	Marks
(a) <b>Investment income</b>	
(i) <b>Rental income from the property in Australia</b>	
Derived in Australia, reason	0.5 + 0.5
Remitted, but specifically exempt	0.5 + 0.5
	<hr/> 2 <hr/>
(ii) <b>Interest on deposit with a UK bank</b>	
Derived in UK, reason	0.5 + 0.5
Not remitted, not taxable	0.5 + 0.5
	<hr/> 2 <hr/>
(iii) <b>Cash distributions from the REITs</b>	
Derived, taxable	0.5 + 0.5
Specific withholding of tax at source, rate	0.5 + 0.5
Final tax, no need to report in annual return	0.5 + 0.5
	<hr/> 3 <hr/>
(iv) <b>Shares in companies listed on the Bursa Malaysia</b>	
Gain on disposal: capital, reason	0.5 + 0.5
No capital gains tax, reason	0.5 + 0.5
Dividends derived in Malaysia, single-tier, specifically exempt	0.5 + 0.5 + 0.5
<b>Available</b>	<hr/> 3.5 <hr/>
<b>Maximum</b>	<hr/> 3 <hr/>
(v) <b>LLP</b>	
Salary: taxable as employment income, reason	0.5 + 0.5
Distribution of profits: not taxable, reason	0.5 + 0.5
	<hr/> 2 <hr/>
(b) <b>Computation of income tax payable for YA 2021</b>	
Income	
Rental income from Australia	0.5
Interest income	0.5
REIT distribution	0.5
Gain from disposal of shares	0.5
Dividends 0.5	
Employment income	1
LLP 0.5	
Personal reliefs $0.5 \times 2$	1
Tax charged	1
Tax rebate	0.5
Tax payable	0.5
	<hr/> 7 <hr/>

<b>(c) Acquisition of cafe business</b>	
Asset deal	
Business income, taxable	0.5 + 0.5
Deductibility of interest	0.5 + 0.5
Shop lot	0.5 + 0.5
Plant, equipment and fittings: IA and AA	0.5 + 0.5
Share deal	
Dividend income, exempt	0.5 + 0.5
Interest not deductible	0.5
Shop lot – no disposal	0.5
Plant, equipment and fittings – no disposal	0.5
<b>Available</b>	<b>6.5</b>
<b>Maximum</b>	<b>6</b>
	<b>25</b>

## 2 Ms Dolly

### (a) Tax treatment of investment income

#### (i) Rental income from the property in Australia

The scope of charge of Malaysia is the derivation and remittance scope. The rental income from the property in Australia is derived from Australia because the property, ie the source of the income, is located in Australia.

As the RM61,000 was remitted to Malaysia, it is chargeable to tax in Malaysia. Remittance of foreign income to Malaysia is exempted from tax under paragraph 28 Schedule 6 ITA 1967.

Therefore, the remittance of RM61,000 is exempted from income tax in Malaysia.

#### (ii) Interest on deposit with a UK bank

As the deposit is placed with a bank situated in the UK, the interest derived therefrom is derived from the UK. This is a foreign-source of income as the interest is earned in the UK.

The interest was not remitted to Malaysia which is out of the scope of charge to Malaysian tax. The interest is not subject to tax in Malaysia.

#### (iii) Cash distributions from the REITs

The distribution of profit by the REITs is derived from Malaysia as the REITs are listed, approved by the Securities Commission and resident in Malaysia. The distribution is derived from Malaysia and duly subject to income tax in Malaysia.

Any distribution by listed REITs which are exempted from tax at REIT level (for those which comply with the 90% distribution criteria) must be subject to a final withholding tax rate of 10% for individuals (resident and non-resident).

Hence, Dolly is subject to withholding tax at 10% in respect of the REITs distribution.

The tax thus deducted at source constitutes the final tax, which means Dolly is not required to report the REITs distribution in her annual income tax return.

#### (iv) Shares in companies listed on the Bursa Malaysia

The gains of RM25,000 from selling shares in one company out of 11 held by her, appears to be capital in nature as the intention is for investment rather than trading. As these are shares in listed companies the treatment of real property company shares under the Real Property gain Tax Act 1976 is not applicable. Therefore the gains on disposal of one of her share investments is capital in nature and not subject to income tax in Malaysia.



The dividends are derived from Malaysia because the distributing companies that are listed on the Bursa Malaysia are resident in Malaysia.

The dividends amounting to RM14,600 from the remaining ten listed companies are single-tier exempt dividends. There is a specific provision under Schedule 6 ITA 1967 which exempts single-tier dividends.

Hence the RM14,600 dividends are exempted from tax.

(v) **LLP**

The salary of RM48,000 received by Dolly is provided for in the partnership agreement. It therefore constitutes income to Dolly and is assessable on her as employment income.

The profit distribution of RM30,800 to Dolly is not assessable on her because such a distribution is also specifically exempted from tax under Schedule 6 ITA 1967.

(b) **Computation of income tax payable for YA 2021**

	RM	RM
Income		
Rental income from Australia		0
Interest income		0
REIT distribution		0
Gain from disposal of shares		0
Dividend (single tier)		0
Employment income: salary from LLP		48,000
LLP – profit distribution		0
Aggregate income/total income		48,000
Less: Personal reliefs		
Individual – self	9,000	
Child – higher rate	8,000	
		(17,000)
Chargeable income (CI)		31,000
Tax charged on first RM20,000		150
Tax charged on the next RM11,000 at 3%		330
Tax charged		480
Less: Tax rebate (CI not exceeding RM35,000)		(400)
Tax payable		80

(c) **Mode of acquisition of the cafe business**

	<u>Asset deal</u>	<u>Share Deal</u>
(i) <b>Classification of income</b>	Business profits belong to Dolly as the sole proprietor; subject to income tax as business profits	Single-tier dividend income; specifically [paragraph 12B, Schedule 6] tax exempt
(ii) <b>Deductibility of the interest expense</b>	Interest is tax deductible as the loan is laid out for assets used in the business.	Loan interest expense is specifically not tax deductible [paragraph 12B, Schedule 6].
(iii) <b>Shop lot</b>	Dolly will acquire the shop lot and since it is real property, comes under the scope of real property gains tax (RPGT). An RPGT return needs to be completed by Dolly as the acquirer. She is also required to comply with retention sum of 3%	There is no disposal of the shop lot.  The company continues to own the shop lot. There are no RPGT implications

	<u>Asset deal</u>	<u>Share Deal</u>
(iv) <b>Plant, equipment and furniture</b>	Dolly will acquire these business assets. She will qualify for initial allowance and annual allowance for these assets in the first year of ownership.	There is no disposal/acquisition of these business assets as the company continues to own them and can continue to claim capital allowances on them following the change in ownership.

## Question 3

### Marking scheme

	Marks
(a) <b>Edward</b>	
(i) <b>Apartment</b>	
Acquisition price	2
Acquisition	1
<b>Coconut plantation land</b>	
Acquisition	1
Acquisition	1
	<hr/> 5 <hr/>
(ii) <b>Real property gains tax (RPGT) computation</b>	
Disposal	2
Acquisition price	1
Exemption	1
RPGT liability	1
	<hr/> 5 <hr/>
(b) <b>Maju</b>	
(i) Design fees	2
Construction sum	1
Project management fee	2
	<hr/> 5 <hr/>
(ii) Grant for factory construction	2
Training grant	1.5
Subsidy for material cost	2
	<hr/> 5.5 <hr/>
<b>Available</b>	<b>5</b>
<b>Maximum</b>	<hr/> <b>20</b> <hr/>

3 (a) **Edward**

(i) **Determination of Apartment acquisition date and price**

The apartment was transferred to Edward as a gift from his father when the latter was still alive.

Under the real property gains tax (RPGT) legislation, where the donor and recipient are parent and child, and the donor is a Malaysian citizen, the donor shall be deemed to have received no gain and suffered no loss on the disposal.

The recipient shall be deemed to acquire the asset at an acquisition price equal to the acquisition price paid by the donor, plus the permitted expenses incurred by the donor.

However, as the property was acquired by Danny prior to 1 January 2013, the acquisition consideration will be substituted by the market value of the asset as at 1 January 2013.

Therefore, only permitted expenses incurred after that date should be taken into account.

The acquisition price to Edward will therefore be calculated as follows:

	RM'000
Original purchase price of RM100,000 is disregarded; adopt market value as at 1 January 2013	500
Add: Permitted expenses – renovation cost	30
Acquisition price	<u>530</u>

The acquisition date is the date when the property was transferred to Edward, ie 2 January 2021.

**Coconut plantation land**

The land was transferred to Edward as a beneficiary pursuant to his father's will.

Therefore, the acquisition price of the property will be based on the market value of the land on the date of the transfer, ie RM1,600,000 under a specific provision of the RPGT Act 1976. [Paragraph 15A, Schedule 2].

The acquisition date is the date when the property was transferred to Edward, ie 3 June 2021.

(ii) **RPGT computation for part disposal of coconut plantation land**

	RM'000
Sale consideration	950
Less: Replanting expenses	0
Less: Construction of store	(80)
Less: Valuation fee ( $2/4 \times \text{RM}60,000$ )	<u>(30)</u>
Disposal price	840
Acquisition consideration ( $2/4 \times \text{RM}1,600,000$ )	<u>(800)</u>
Chargeable gain	40
Less: Exemption – 10% of chargeable gain or ( $2/4 \times \text{RM}10,000$ ) whichever is higher	<u>(5)</u>
Gain subject to RPGT	35
RPGT payable at 30% (disposal within three years of acquisition)	<u>10.5</u>

(b) **Maju Sdn Bhd (Maju)**

(i) **Service tax implications**

**Design fees payable to a Singapore architect firm**

Imported taxable services incurred for the furtherance of the company's business in Malaysia is subject to service tax. As design is a taxable service, the design fee payable to the Singapore architect firm is subject to service tax, notwithstanding that the service may be rendered outside Malaysia.

Maju, as the recipient of imported taxable services, is required to account for service tax. As Maju is not registered for service tax, it is required to account for the service tax using a prescribed form by the last day of the month following that in which the imported taxable services are paid for or the invoice is received, whichever is earlier.

The service tax is 6% of the consideration paid, ie RM60,000 ( $6\% \times \text{RM1,000,000}$ ).

**Construction cost paid to a local construction company**

Construction services are not regarded as a taxable service and, therefore, the amount payable is not subject to service tax.

**Project management fees payable to Success Sdn Bhd (SSB)**

Project management is a taxable service under Group G First Schedule of the Service Tax Regulation 2018. As SSB only provides the service to wholly-owned subsidiaries, and does not provide the same taxable service to non-group companies, it is eligible for intra-group relief. Service tax would not be applicable as it is treated as non-taxable service

(ii) **Grant and subsidy**

**Grant from the Malaysian Investment Development Authority (MIDA)**

There is a specific exemption order which exempts grants and subsidies given by the Government of Malaysia and State Government. The exemption order further provides that any expenditure or expenses which are covered by the grant or subsidy are not eligible for tax deduction nor do they constitute qualifying capital expenditure for capital allowance purposes. (The Income Tax Exemption (No 22) Order 2006).

The grant of RM3 million to construct the factory is exempted from income tax. However, the amount subsidised will not be form part of the qualifying capital expenditure for capital allowances. As such, Maju will only be able to claim capital allowances based on qualifying capital expenditure of RM9.5 million (RM12.5 million – RM3 million).

Similarly, the training grant received will be exempted from income tax. However, the portion of the expenses subsidised will not be allowed for tax deduction.

**Subsidy for purchase of raw material cost**

Where subsidies received are for the replacement/acquisition of capital assets, the amount is not taxable. On the other hand, a grant/subsidy which is received to compensate for revenue loss or to cover revenue expenditure is subject to income tax.

As the subsidy is given to cover the high raw material cost (ie operating expenditure), the subsidy is taxable. However, the raw material cost incurred will qualify for tax deduction. Therefore, the net effect is likely would not result in any additional tax payable.

## Question 4

### Marking scheme

	Marks
(a) Fantastic Sdn Bhd	
Royalty expense	
Withholding tax due when royalty paid, revised assessment, timing	1 + 1 + 1
Interest expense	
When deductible, reduced assessment, timing	<u>1 + 1 + 1</u>
	6
(b) (i) GHL Sdn Bhd	
Status quo Tax calculation	4
Proposed merger Tax calculation	3
Analysis	3
	<u>10</u>
Available	10
Maximum	<u>9</u>
(ii) Tax avoidance	
Rule/commercial substance	2
Analysis	2
Conclusion	1
	<u>5</u>
	<u>20</u>

#### 4 (a) Fantastic Sdn Bhd (FSB)

##### Royalty expense

When the tax return for YA 2018 was submitted, the withholding tax on the royalty had not been remitted to the Director General of Inland Revenue (DGIRI). Therefore, FSB did not claim a tax deduction at that point.

Once the withholding tax on the royalty has been remitted, FSB will be entitled to the tax deduction. Palm can make an application to the DGIR to claim a deduction for the royalty expense. The application must be submitted within one year after the end of the year in which the payment is made under a specific tax provision of the Income Tax Act 1967. As the withholding tax payment was made in 2021, FSB has up to 31 December 2022 to make the application to claim the royalty expense as a deduction.

##### Interest expense

When the tax return for YA 2018 was prepared for tax submission the interest expense should not be claimed as tax deductible as the amount was not due to be paid then. The interest, when it is due to be paid, can be deducted in arriving at the company's adjusted income for the period in which the interest is payable.

The company should notify the DGIR in writing regarding the interest deduction not later than 12 months from the end of the basis period for the YA when the sum is due to be paid. Upon receipt of the notice, the DGIR may reduce the assessment to give effect to the interest expense deduction. FSB is required notify the DGIR by 31 December 2022 as the interest was due to be paid on 30 June 2021.

(b) (i) **GHL Sdn Bhd**

**Before any merger of business, ie status quo**

<b>GHL</b>	<b>RM'000</b>	<b>RM'000</b>
Unabsorbed capital allowance	5,000	
Less: Utilisation from YAs 2022 to 2026 (RM1,000,000 × 5 years)	<u>(5,000)</u>	0
Tax losses able to be utilised after the entire unabsorbed CA being absorbed		
Unabsorbed tax losses from Y/A 2021 allowed to be carried forward until Y/A 2028	15,000	
Less: Utilisation for YA 2027 and YA 2028	<u>(2,000)</u>	
Amount disregarded (time limit of seven years)	<u>13,000</u>	
Unabsorbed loss c/f to Y/A 2029	<u>0</u>	
Adjusted/chargeable income (annual) for YA 2029	<u>1,000</u>	
Total tax liability for YA 2029 at 24% (of RM1 million)		240
<b>HLB</b>		
Adjusted income for YA 2022	4,000	
Less: Pioneer losses	<u>(500)</u>	
Chargeable income	3,500	
Tax liability at 24%		840
Adjusted/chargeable income (annual) for YAs 2023 to 2029	4,000	
Total tax liability for 7 YAs at 24% × RM28 million (RM4 million × 7 YAs)		<u>6,720</u>
Total tax exposure for eight years		<u>7,800</u>

Based on the above, GHL will not be in a tax-paying position up to YA 2028 as its profits generated from the personal computer manufacturing of RM1 million annually can be sheltered by the unabsorbed capital allowances (CAs) and tax losses.

For the first five YAs (YA 2022 to 2026), GHL will be utilising the unabsorbed CAs. GHL will only start utilising its tax losses from YA 2027 onwards. However, with the seven-year time limit to carry forward tax losses, GHL cannot continue to carry forward the tax losses beyond YA 2028. This means that the tax losses can only be utilised for two years in YA 2027 and YA 2028. The remaining tax losses will be disregarded.

For HLB, the profits from the notebook manufacturing will be subject to income tax without any shelter of tax losses, other than YA 2022 where the company can utilise the pioneer loss of RM500,000.

**Proposed merger of businesses under DW**

The notebook manufacturing business under HLB is profitable while the personal computer manufacturing business under GHL is incurring losses. In addition, GHL has unabsorbed CAs and tax losses. By transferring the business of HLB to GHL, since both manufacturing activities relate to the production of IT equipment, it can be argued that, after merger, the two activities can reasonably be treated as a single source of business. In this regard, the profits from the merged business can be sheltered by first the unabsorbed CAs, and, next, the unabsorbed tax losses.

<b>GHL (HLB merged with GHL)</b>	<b>RM'000</b>	<b>RM'000</b>
Unabsorbed CAs	5,000	
Less: Utilisation from YA 2022 (RM1,000,000 + RM4,000,000)	<u>(5,000)</u>	0
Unabsorbed tax losses	15,000	
Less: Utilisation for YA 2022 to 2025 (3 years × RM5,000,000)	<u>(15,000)</u>	0
CA and losses fully absorbed by YA 2025. Tax payable from YA 2026 shall be:		
Adjusted/chargeable income (annual) from YAs 2026 to 2029 RM5 million × 4 YAs	20,000	
Total tax liability for four years at 24% × RM20 million		<u>4,800</u>
<b>HLB</b>		
Pioneer loss (disregarded)-note	<u>500</u>	
Chargeable income/tax liability		<u>0</u>
Total tax exposure for eight years		<u>4,800</u>

Based on the combined profits of RM5 million, the unabsorbed CAs and tax losses can be utilised within four years. Thereafter, the profits will be subject to income tax.

**Note.** As HLB will become dormant, the pioneer loss of RM500,000 will be lost.

### Analysis

Notwithstanding that HLB has to forgo the pioneer loss of RM500,000, the proposed merger is tax efficient as it will accelerate the utilisation of the tax losses and also ensure that the amount can be fully utilised prior to its expiry in YA 2027. Without the merger, a significant amount of the tax losses, ie RM14 million, will be lost.

#### (ii) Tax avoidance

The general anti-avoidance provision provides that where the Director General of Inland Revenue (DGIR) has reason to believe that any transaction has the direct or indirect effect of altering the incidence of tax which is payable or which would otherwise have been payable by any person, he may disregard or vary the transaction and make such adjustments as he thinks fit for tax purposes with a view to counter-acting the whole or any part of any such direct or indirect effect of the transaction [section.140 the Income Tax Act 1967].

However, based on established case law, if a transaction is capable of justification by reference to ordinary business dealings without necessarily being labelled as a means to avoid tax, then the arrangement should not be caught by the anti-avoidance provision. It is, therefore, of great importance that the taxpayer is able to demonstrate that any transaction entered into is driven by commercial expediency, and that any tax benefit derived is purely incidental, in order for it to counter any challenge of tax avoidance by the tax authorities.

In the present case, as both GHL and HLB are involved in the manufacturing of IT equipment, it makes commercial sense for the business of the two companies to be merged. The notebook manufacturing was undertaken under a separate company earlier to facilitate the pioneer status application, and since the pioneer period has ended, the management has decided to combine the businesses together.

As to the choice of the surviving company being GHL, it can be argued that as GHL is the holding company, it is more practical to combine the businesses under GHL so that HLB can subsequently be liquidated. Had the business been merged under HLB, GHL would become dormant and to liquidate GHL is more complex in view of the fact that it has a shareholding in HLB.

Therefore, GHL should be able to argue that the proposed merger of businesses has commercial justifications and it should reasonably be able to argue against an DGIR to invoke the anti-avoidance provisions.