Professional Level – Options Module

Advanced Taxation (Malaysia)

Friday 15 June 2012

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

Tax rates and allowances are on pages 2–4

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)

ACCA

SUPPLEMENTARY INSTRUCTIONS

1. You should assume that the tax rates and allowances shown below will continue to apply for the foreseeable future.
2. Calculations and workings should be made to the nearest RM.
3. All apportionments should be made to the nearest whole month.
4. All workings should be shown.

TAX RATES AND ALLOWANCES

The following tax rates, allowances and values are to be used in answering the questions.

Income tax rates

Resident individual

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	12	3,325
20,000	70,000	19	7,125
30,000	100,000	24	14,325
Excess		26	

Non-resident individual

All chargeable income	26%

Resident company

Paid up ordinary share capital	RM2,500,000 or less	More than RM2,500,000
On the first RM500,000	20%	25%
On the remainder	25%	25%

Non-resident company

All chargeable income	25%

Labuan entity

income from a Labuan business activity

All chargeable income	3%

Trust body – resident or non-resident

All chargeable income	25%

Personal deductions

		RM
Self		9,000
Self – additional if disabled		6,000
Spouse		3,000
Spouse – additional if disabled		3,500
Child – basic rate	each	1,000
Child – higher rate	each	4,000
Disabled child	each	5,000
Disabled child – additional	each	4,000
Life insurance premiums, approved scheme contributions	maximum	6,000
Deferred annuity premium	maximum	1,000
Medical expenses for parents	maximum	5,000
Medical expenses for serious disease of self, spouse or child, including up to RM500 for medical examination	maximum	5,000
Basic supporting equipment for self, spouse, child or parent if disabled	maximum	5,000
Educational and medical insurance for self, spouse or child	maximum	3,000
Study course fees for skills or qualifications	maximum	5,000
Broadband subscription	maximum	500
Purchase of a personal computer	maximum	3,000
Purchase of books, magazines etc for personal use	maximum	1,000
Purchase of sports equipment	maximum	300
Deposit for a child into the National Education Savings Scheme	maximum	3,000

Rebates

Chargeable income not exceeding RM35,000	**RM**
Individual – basic rate	400
Individual entitled to a deduction for a spouse or a former wife	800

Capital allowances

	Initial rate %	Annual rate %
Industrial buildings	10	3
Plant and machinery – general	20	14
Motor vehicles and heavy machinery	20	20
Office equipment, furniture and fittings	20	10

Real property gains tax

Disposal by all persons (except non-citizen individuals)

Date of disposal	**Rate %**
Disposal within two years after the date of acquisition	30
Disposal in the third year after the date of acquisition	20
Disposal in the fourth year after the date of acquisition	15
Disposal in the fifth year after the date of acquisition or thereafter	5

Note: an exemption is granted which reduces the effective rate of tax to 5% where disposal takes place within five years of acquisition and to nil thereafter.

Sales and service tax

	Rate %
Sales tax	10
Service tax	6

Stamp duty

Rates of duty under the First Schedule

Conveyance, assignment, transfer or absolute bill of sale	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 are compulsory and MUST be attempted

1 Moodes Sdn Bhd (MSB), a producer of casual wear made with imported textile, closes its accounts annually to 31 December.

MSB's business is constantly evolving: new product lines are acquired or developed and existing lines are disposed of. A product line comprises the registered trademark, patented designs and brand name.

As at 1 January 2012, MSB owned a total of 18 product lines, one of which, swimwear, was sold for RM12·8 million in May 2012. Under the sale and purchase agreement, this amount is payable to MSB in eight equal quarterly payments as follows:

	RM'000
2012: June, September and December	4,800
2013: March, June, September and December	6,400
2014: March	1,600

MSB does not expect the disposal of the swimwear product line to reduce the company's turnover as sales of its other casual wear product lines are expected to rise significantly. In fact, MSB will recruit more staff to cope with the increase.

In July 2011, MSB obtained the requisite Government approval for its research project to develop world pioneering technology for producing synthetic gold. MSB is therefore eligible for the tax incentive for approved research and development (R&D).

In connection with this, MSB incurred expenditure as follows during the period 1 July to 31 December 2011:

	RM'000
Remuneration for research personnel	1,500
Costs of laboratory testing, analysis and evaluation	800
Royalty paid to a Malaysian resident for secret processes	700
Research equipment and assets	2,000
Total R&D expenditure on the approved R&D project	5,000

The RM5 million is reflected as R&D expenditure in MSB's balance sheet as at 31 December 2011.

The adjusted income of MSB for the year of assessment 2011 before taking into account the incentive for approved R&D is RM10 million, and the capital allowance for assets other than the R&D assets is RM1 million.

Required:

Prepare a report from the company's tax adviser to Moodes Sdn Bhd's financial controller, which addresses the following:

(i) With reference to the sale of the swimwear product line:

(1) The arguments for both the capital and revenue nature of the RM12·8 million received and your conclusion, supported with reasons, on this issue. (8 marks)

(2) Assuming that the RM12·8 million receipt is income in nature, the possible bases of recognition for income tax purposes and your conclusion as to which basis is applicable. (8 marks)

(ii) The nature of the approved research and development (R&D) incentive and the eligibility (or otherwise) of every item of the expenditure incurred by Moodes Sdn Bhd (MSB) in relation to the research project in the period ended 31 December 2011, together with any other relevant aspects of their tax treatment;

Support your explanations with a computation of MSB's statutory income for the year of assessment 2011, indicating by the use of the word 'nil' any item referred to in the scenario for which no adjusting entry needs to be made in the tax computation. (16 marks)

Professional marks will be awarded in question 1 for the appropriateness of the format of the report and the effectiveness with which the information is communicated. (4 marks)

(36 marks)

2 Pursuant to a merger agreement between Big Sdn Bhd (Big) and Small Sdn Bhd (Small), Big will acquire the entire shareholding of Small on 15 July 2012. Thereafter, on 1 August 2012 Small will transfer all the assets (some of which were acquired on 5 June 2012), liabilities and activities of its trading business to Big to be merged with Big's trading business from 1 August 2012.

Both companies trade in home appliances. Big closes its accounts annually to 31 July while Small closes its accounts annually to 31 May.

Extracts of information from Small's financial statements as at 31 May 2012 are as follows:

	RM'000
Unabsorbed business loss carried forward	10
Unabsorbed capital allowance carried forward	50
Trade receivables	900
Inventory at net realisable value	280
S.108 balance	75
Exempt account balance	130
Retained earnings	590

Required:

Explain the following issues arising from the impending takeover and merger:

(a) **Bearing in mind the basis of inventory valuation for an on-going business and that for a business going into cessation, the strategy that should be adopted by Small Sdn Bhd for inventory valuation at the time of transfer of the company's business to Big Sdn Bhd.** (9 marks)

(b) **The dividend distribution policy that should be adopted by Small Sdn Bhd, together with a computation of the component dividends that may be distributed.** (5 marks)

(c) **The course of action that should be taken by Small Sdn Bhd regarding the trade receivables.** (4 marks)

(d) **Why the controlled sale provisions will apply to the transfer, and the entitlement to capital allowances (initial, annual, balancing allowance and balancing charge) available to Big Sdn Bhd and Small Sdn Bhd respectively, in relation to the transferred assets for the years of assessment 2012 and 2013.** (10 marks)

(28 marks)

Section B – TWO questions ONLY to be attempted

3 On 1 February 2011, Mr Grandpa signed a written agreement to transfer a shop house as a birthday gift to his granddaughter, Niki, who turned 21 years of age on that day. Niki is single and a student at a local university.

The shop house had a market value of RM590,000 on 1 February 2011 and produces a rental income of RM5,000 per month. Mr Grandpa had acquired the shop house on 13 March 2007 at a cost of RM380,000.

Required:

(a) Explain why the transfer of the shop house by Mr Grandpa to Niki constitutes a settlement under s.65 of the Income Tax Act for the year of assessment 2011, and state the significance of such a settlement for income tax purposes. (7 marks)

(b) Explain the income tax treatment of the rental income from the shop house for both Mr Grandpa and Niki for the years of assessment 2011 and 2012, clearly identifying when (when not) the deeming provisions apply. (6 marks)

(c) Explain the real property gains tax treatment of the transfer of the shop house with respect to Mr Grandpa and Niki, stating clearly Niki's acquisition date and acquisition price. (5 marks)

(18 marks)

4 A foreign publishing company (FPC) carries out its main publishing functions such as liaison with writers, editorial work and global marketing in the foreign country of Halvana, where it is resident. FPC does not have an office, a branch or any appreciable presence in Malaysia.

FPC has appointed Mr A as its representative in Malaysia. Mr A works exclusively for FPC, he works from his home in Malaysia, taking instructions and communicating with the distribution department of FPC through the telephone and email. Mr A is not vested with authority to enter into contracts on behalf of FPC. He is paid a fixed monthly remuneration by FPC into his bank account in Halvana.

Mr A's duties include:

– liaising with the Malaysian contractors appointed by FPC to carry out the printing of its many publications;
– ensuring that the printed publications are transported or shipped to buyers in Malaysia and the Asia-Pacific region; and
– submitting reports regularly to FPC's distribution department to facilitate direct payments to the independent contractors and shippers.

There is a double tax agreement between Malaysia and Halvana.

Required:

(a) State, with reasons, whether the relationship of Mr A and the foreign publishing company (FPC) is one of master–servant or principal–agent. (3 marks)

(b) Explain whether Mr A will be subject to tax in Malaysia in respect of the remuneration he receives from FPC. (5 marks)

(c) Explain whether FPC will have a permanent establishment in Malaysia. (6 marks)

(d) Explain the significance of FPC having a permanent establishment in Malaysia. (4 marks)

(18 marks)

5 On 1 April 2009, Vroom Sdn Bhd (Vroom), a newly incorporated company, was granted a concession by the Malaysian Government. Under this concession, Vroom would design, build and operate a tolled motorway and ancillary services such as food outlets for 30 years, after which it will hand over the motorway to the Government for RM1.

Vroom secured financing of RM200 million for the project on 4 June 2009, at which time it appointed professional consultants for the design and survey component of the project. The design work commenced on 1 July 2009 and construction began on 2 January 2010. The motorway was opened to the public on 1 January 2011.

Vroom's principal source of revenue is the toll collections from users of the motorway and rental income from the food outlets in the motorway rest area.

Vroom, which closes its accounts annually to 31 December, incurred qualifying expenditure on the motorway as follows:

	RM million
Public road	100
Ancillary structures:	
Toll booths and office buildings	10
Rest area structures	5

Required:

(a) For each of the five dates referred to in the scenario, state, with reasons, whether that is (is not) the date on which Vroom Sdn Bhd (Vroom) commenced its business. (7 marks)

(b) With reference to the rental income received by Vroom from the food outlets in the rest area:

(i) State, with reasons, whether you would classify the income as rental income (under s.4(d)) or as part of the business income from operating the motorway (under s.4(a)); (4 marks)

(ii) Explain the income tax impact if the rental income received from the food outlets is classified as rental income (under s.4(d)). (4 marks)

(c) Assuming that the rental income is part of the business of operating the motorway, state, with reasons, from when Vroom is first eligible for the industrial building allowance and compute the allowance available in the first year of assessment if the annual allowance rate for public road and ancillary structures is 6%. (3 marks)

(18 marks)

End of Question Paper