

TAX UPDATE

1st Quarter 2011

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TAX DEVELOPMENTS

PUBLIC RULINGS (PR)

The Inland Revenue Board (IRB) has issued 2 Public Rulings on 7 February 2011 as follows:-

PR No. 1/ 2011 - Taxation Of Malaysian Employees Seconded Overseas

The Ruling explains the tax treatment of employment income derived from Malaysia by employees who are seconded by their employer to perform duties outside Malaysia. Some of the key points are as follows:-

1. Employment income

Income from an employment is deemed derived from Malaysia if the income arises for any period:-

- a) during which the employment is exercised in Malaysia;
- b) leave is attributable to the exercise of the employment in Malaysia;
- c) during which the employee performs outside Malaysia duties incidental to the exercise of the employment in Malaysia; or
- d) during which the employment is exercised aboard a ship or aircraft used in a business of a person resident in Malaysia.

2. Determination of incidental duties

The word 'incidental' has not been defined in the Income Tax Act. However, based on the principles laid down in case laws, incidental duties may be considered as duties that are connected to the duties of the main employment and which constitutes a necessary part of an employment. Incidental duties are exercised not to serve any independent purpose but to fulfill the purpose of the main employment.

If the overseas secondment is considered as incidental duties to the main employment, then the income will be deemed derived in Malaysia and thus, taxable in Malaysia.

Some of the factors and circumstances to be considered collectively in determining whether the duties of an employee on overseas secondment are incidental to the exercise of the employment in Malaysia are:-

- i) Was the employment exercised in Malaysia prior to the secondment overseas?
- ii) What was the nature of the overseas duties?

- iii) What was the purpose of the overseas duties?
- iv) Were the overseas duties temporary in nature? Will the employee resume work with his employer in Malaysia upon completion of the overseas duties?
- v) Where does the direction and control of the employee's duties come from?
- vi) Who bears the cost of the employee's remuneration during the overseas secondment?
- vii) Who bears the risk and directly enjoys the economic benefits from the performance of the employee's overseas duties?

It is important for both employers and employees to carefully assess their own specific factors and circumstances to ensure that the correct tax treatment is accorded. The PR is available on the IRB website at http://www.hasil.org.my/pdf/pdfam/PR1_2011.pdf

PR No. 2/2011 - Interest Expense And Interest Restriction

This Ruling explains the deductibility of interest expense against business and investment income effective from the Year of Assessment 2011 onwards. The salient points of the Ruling are as follows:-

1. Deductibility of interest expense

- Interest on money borrowed to finance the construction of a business asset such as a building or plant for its own use is a deductible business expense as the money borrowed was laid out on asset held for the production of income. However, it would not be given any deduction if such interest is incurred prior to the commencement of the business.
- No restriction will be calculated on the interest expense if a person is able to substantiate to the satisfaction of the IRB that the non-business investment or loans given to other persons have not been made directly or indirectly out of the money borrowed.
- For the purpose of deducting interest expense against dividends, interest or rental income, all investments in portfolio shares, loans or properties of the respective sources should be aggregated regardless of whether they are income producing or non-income producing.
- Interest incurred on money borrowed to finance investments which produce income that is exempted from tax and interest-free loans to related parties are not deductible.

2. Refinancing of loan

Interest incurred on the refinancing of an existing loan is deductible provided the earlier loan was taken for the purpose of producing the business income. However, the deductible interest is restricted to the balance of the earlier loan taken if the refinancing loan is higher.

3. Deferred payment credit

Where assets are acquired under the deferred payment credit scheme, the difference between the deferred payment and the cash price constitutes deferred interest which is deductible.

The PR is available on the IRB website at http://www.hasil.org.my/pdf/pdfam/PR2_2011.pdf

CLAIM FOR RELIEF ON PARENTS' MEDICAL EXPENSES

An individual can claim relief up to RM5,000 for medical expenses incurred in a basis year for his parents provided that the claim is evidenced by a medical practitioner certification. Effective from the Year of Assessment 2011, the relief has been extended to include expenses incurred for special needs or carer expenses subject to the following conditions:-

- (a) "parents" shall be individuals resident in Malaysia;
- (b) the medical treatment and care services are provided in Malaysia; and
- (c) the medical practitioner is registered with the Malaysian Medical Council.

THIN CAPITALIZATION RULES POSTPONED

The implementation of the thin capitalization rules which was supposed to be effective from 1 January 2009 has been deferred to the end of December 2012. In view of this, thin capitalization will take effect from January 2013.

Please contact the following persons if you need any assistance on the above:-

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TAX ADMINISTRATION

INCOME TAX RETURN FORMS FOR YEAR OF ASSESSMENT 2010

All taxpayers will receive the 2010 income tax return forms latest by the middle of February 2011. However, income tax return forms will not be issued to taxpayers who e-filed for the Year of Assessment 2009 and those with employment income of less than RM26,000 in the year 2009.

The following categories of taxpayer will be required to file their tax returns electronically:-

- (a) Taxpayers with employment income of more than RM26,000 in 2010
- (b) Taxpayers requesting for a refund of excess payment of tax
- (c) Taxpayers who are not taxable but have been paying taxes through the Schedular Tax Deduction

The due dates for submission of the tax returns are as follows:-

Source of Income	Due Date
Non-business income (such as employment, rental, dividend, interest, pension and other gains or profits)	30 April 2011
Business income (such as sole proprietor, partnership and association)	30 June 2011

TAX CASES

EMSB v. KETUA PENGARAH HASIL DALAM NEGERI

Subject

1. Whether the payment described as “royalty” expenses paid for advertising, marketing and technical support were wholly and exclusively incurred in the production of gross income within the meaning of Section 33 of the Income Tax Act, 1967.
2. Whether the Inland Revenue Board (IRB) was correct in raising an assessment outside the 6 year time bar limit.

Facts

The principal activities of EM Sdn Bhd (EMSB) are marketing and distributing of household cleaning products manufactured by GC Sdn Bhd (GCSB). Both companies are part of a group of companies controlled by one individual. EMSB paid “royalties”, which was actually expenses incurred on advertisement, sales promotion and technical support fees, to GCSB. These expenses were incurred by GCSB and subsequently charged to EMSB by debit notes.

Advertising was an important component of the business of the companies. There were two types of promotional and advertising expenses incurred by the companies:-

- (a) Above the line advertising and promotion expenses, namely TV, radio, outdoor advertising, newspaper and magazine incurred by GCSB
- (b) Below the line advertising and promotion expenses namely in store and supermarkets promotion and point of sale advertising materials etc incurred by EMSB

The Inland Revenue Board (IRB) disallowed a portion of the ‘royalties’ for the Years of Assessment (YA) 1992 to 1994 and YA 1996 to 1999 as EMSB has failed to provide evidence that the payments were indeed made for advertising, marketing and technical support.

The assessments were raised beyond 6 years after expiration of the years of assessment in question.

EMSB appealed to the Special Commissioners of Income Tax (SC) against the assessments.

Decision

1. The SC dismissed the taxpayer’s appeal. The names or labels given in accounting records are irrelevant. What is important is the substance of the purpose of the payment which determines the nature of payment.

What remains is to establish the purpose of the payments described as “royalties” in the accounts. EMSB failed to provide evidence that the payments were part of the purchase price in the form of payment for advertising, marketing and technical support. Invoices and debit notes issued by GCSB are not conclusive evidence of the “royalty” payments. Pursuant to Para 13 of Schedule 5 of the Income Tax Act, 1967 (the Act), the onus of proving that an assessment is excessive or erroneous lies with the taxpayer. As EMSB has failed to produce the supporting documents for the “royalty” expenditure it actually incurred, EMSB had failed to discharge this onus.

2. Though under the Act the IRB should not issue an assessment or additional assessment beyond the 6 years time bar, the IRB may still do so if it appears that any one of the elements of fraud or willful default has been committed by or on behalf of any person or any person has been negligent.

In this case, EMSB was unable to account for the “royalty” expenses despite numerous requests for the supporting documents. The IRB has therefore established a prima facie case of willful default of excessive amount claimed.

EMSB being dissatisfied with the SC decision has appealed to the High Court.

SM Sdn Bhd v KETUA PENGARAH HASIL DALAM NEGERI

Subject

Whether airfare and accommodation expenses incurred by a company trading in pharmaceutical products for medical seminars and convention in promotion of its products were “entertainment” and thus not allowable as deduction.

Facts

SM Sdn Bhd (SMSB) is in the business of trading in pharmaceutical products and sells specialist medications. Some of the medications were sold over the counter and some required doctor’s prescription. SMSB drove its sales primarily through:-

- (a) Medical representatives who visited doctors to promote its drugs; and
- (b) The dissemination of knowledge to doctors on the benefits of its drugs by sending these doctors to medical events (including seminars and conventions)

held in Malaysia and overseas. These Malaysian doctors then become speakers at local medical events organized by SMSB.

The Inland Revenue Board (IRB) allowed the deduction relating to the medical events, with the exception of airfare and accommodation expenses incurred amounting to RM719,726 in the Year of Assessment 2002. The IRB has classified the above expenses as entertainment expenses and disallowed it.

SMSB appealed to the Special Commissioners of Income Tax (SC) against the assessments.

Decision

The Special Commissioners of Income Tax (SC) ruled in favour of the taxpayer. The airfare and accommodation expenses were held to be incurred for the sole purpose of promoting EMSB's business. By sending the leading Malaysian doctors to the overseas medical events and organizing local medical events, EMSB had been able to successfully promote and sell its specialists medications. The expenses were incurred solely to promote EMSB's business and not for the purpose of providing hospitality to the doctors. Consequent to the promotion strategy, EMSB had increased the sales of its specialists medications.

The material contained in this newsletter is in the nature of general comment and information only and neither purports, nor is intended, to be advice on any particular matter. Readers should not act or rely upon any matter or information contained in or implied by this publication without taking specific professional advice.

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