

EXEMPTIONS AND EXCLUSIONS FROM ASSESSABLE INCOME

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CONCEPT OF EXEMPTIONS

¶8-100 Meaning of exempt income

Section 127 of the *Income Tax Act 1967* (ITA) empowers the Minister of Finance to declare exemptions from income tax and states that the income specified in Pt I of Sch 6 shall be exempt from tax.

With effect from YA 2001, a person whose income is exempt under the repealed *Income Tax Ordinance 1956* of Sabah, *Inland Revenue Ordinance 1960* of Sarawak and *Income Tax Ordinance 1947* of West Malaysia and deemed to be exempt under s 127 will no longer enjoy this exemption.

“Exempt income” simply means income that is excluded from a tax liability. The two expressions “not liable to tax” and “exempt from tax” are not synonymous. For example, a capital receipt does not have the quality of income and does not therefore form part of the assessable income of a person. On the other hand exempt income can have the character of income but is specifically excluded from assessable income.

Income is exempted for various reasons, eg:

- to encourage overseas investments
- to encourage thrift among citizens
- because of the special nature of the income or the special position of the taxpayer
- reciprocity through double taxation agreements or diplomatic ties, etc.

Law: s 127, Sch 6.

RULERS

¶8-200 Official emoluments

All emoluments attached to the office of a Ruler or Ruling Chief are exempt from income tax. These persons include:

- the Yang di-Pertuan Agong (The King)
- the Raja Permaisuri Agong (The Queen)
- the Timbalan Yang di-Pertuan Agong or any other Ruler exercising the functions of the Yang di-Pertuan Agong
- a state authority or any person exercising the functions of a state authority
- the Undang of Sungei Ujong
- the Undang of Jelebu
- the Undang of Johol
- the Undang of Rembau
- the Tunku Besar of Tampin
- the Consort of the Ruler of a state having a title of Raja Perempuan, Sultanah, Raja Permaisuri, Tengku Ampuan, Tengku Permaisuri or Permaisuri, and
- a former Ruler or Ruling Chief or a Consort of a former Ruler of a state previously having the title of Raja Perempuan, Sultanah, Raja Permaisuri, Tengku Ampuan, Tengku Permaisuri or Permaisuri.

The exemption is also extended to the emoluments of any person who exercises the functions of a state authority in a temporary or acting capacity.

The exemption is only by reference to the official emoluments of the above persons. Any private income, such as dividends, rents or interest will remain a subject of tax under the ITA.

Law: Sch 6 para 1, 1A, 1B, 2.

INDIVIDUALS

¶8-300 Diplomatic and consular staff

This exemption arises from the general law of diplomatic privileges. Reciprocal exemption is given by countries which have diplomatic ties with each other. Only staff accredited to Malaysia by the country concerned are exempted. If an embassy engages local staff, such as typists, public relations officers, etc, these individuals do not fall within Sch 6 para 3.

Although Sch 6 provides for exemption of income from the above sources, in double taxation conventions (see ¶15-050ff) there is always a common clause which gives exemption to salaries of government servants of one contracting state who are serving in the other contracting state.

Law: Sch 6 para 3, 4.

¶8-305 Commonwealth forces and civil servants of a Commonwealth government

To qualify for exemption under this category the individual must:

- (a) be taxed in the Commonwealth country concerned, and
- (b) be exclusively in the service of the Commonwealth government

The exemption applies only to the emoluments attached to an individual's office. It does not apply to other income, ie investment or business income, derived by him/her in Malaysia. Where the wife of a member of the armed forces or the wife of a civil servant exercises an employment in Malaysia, she is liable to Malaysian income tax in the name of her husband or, if she chooses, in her own name.

Law: Sch 6 para 10.

¶8-310 Gratuities and pensions of government members

Paragraph 30A of Sch 6 provides that any gratuity or pension is exempt from tax if it is derived from Malaysia and paid to a person resident in Malaysia under any written law applicable to:

- the President of the Senate
- the Deputy President of the Senate
- the Speaker of the House of Representatives
- the Deputy Speaker of the House of Representatives
- the Speaker of a State Legislative Assembly
- a member of the Senate
- a member of the House of Representatives, and
- a member of the State Legislative Assembly.

The exemption will apply only if:

- the person has attained the age of 55, or
- the relevant appointment ceases due to ill health.

Should an individual be entitled to more than one pension, the exemption will only apply to the higher or highest pension received.

Law: Sch 6 para 30A.

¶8-315 Bounties

Bounties paid out of funds provided by Parliament to members of the Royal Malaysian Naval Volunteer Reserve, the Malaysian Territorial Army and the Royal Malaysian Air Force Volunteer Reserve are exempt.

Law: Sch 6 para 9.

¶8-320 Civil defence disability pensions

Members of civil defence organisations in any territory comprised in Malaysia on 1 January 1968 who receive disability pensions in respect of war service injuries will not be exposed to tax on such pensions.

Law: Sch 6 para 8.

¶8-325 Armed forces wound and disability pensions

These types of pensions granted to persons in the armed forces in respect of services in Malaysia or in a Commonwealth country or for services before Merdeka Day by volunteer and local defence forces or for services in the Sarawak Volunteer Force or the Sarawak Rangers are exempt. Such pensions granted to wives and dependent relatives of any member of the above forces killed on war service are also tax-free.

Law: Sch 6 para 7.

¶8-330 Pensions to widows, widowers and children

Pensions received by widows and dependants under any Malaysian law or from an approved scheme are tax-free. In the 2011 Budget, the exemption is extended to widowers.

Law: Sch 6 para 16.

¶8-335 Death gratuities

Sums received by way of death gratuities or as consolidated compensation for death or injuries are exempt.

Law: Sch 6 para 14.

¶8-340 Retirement gratuities

Where the DGIR is satisfied that a gratuity is paid to an individual on account of retirement due to ill health, the gratuity will not attract tax. It is also provided that a gratuity paid to an individual who has had 10 years of continuous employment with the same employer, or with companies in the same group, will be exempt if the retirement takes place on or after reaching the age of 55, or on reaching the compulsory age of retirement from employment specified under any written law.



Example 1

Saini, who has been employed by Biggles Sdn Bhd for 15 years, retires in 2011 at the age of 55. He receives a retirement gratuity of RM15,000. The sum will be exempt from tax.



Example 2

In Example 1 above, if Saini had retired at the age of 54, the retirement gratuity would be taxable, although the sum would be spread back over the period of employment, subject to a maximum of six years (s 25(4)).



Example 3

In Example 1 above, if Saini had retired at the age of 54, but the retirement was due to ill health, the retirement gratuity would be exempt from tax.

Exemption is also extended to sums received by way of a gratuity paid out of public funds on termination of a contract of employment (less the employer's contribution to the Employees Provident Fund, if any, and interest thereon). Civil servants who retire early in the interest of the country would qualify for this exemption on the gratuity, if any, paid to them.

In order to relieve the tax burden of employees who retire on a mandatory basis at the age of between 50 and 55, tax exemption will be given on retirement benefits of up to RM6,000 for each completed year of service, effective from YA 2003. Accordingly, where applicable, a revised tax return will have to be submitted to the Inland Revenue Board (IRB) in order to claim a tax refund.

With effect from YA 2007, the retirement benefit for private sector employees who retire at the compulsory retirement age of 50 and above is granted full tax exemption. This exemption is subject to the condition that the compulsory retirement age is provided for in the employment contract or collective agreement between the employer and the employee.

The IRB issued Public Ruling No 10/2011 dated 5 December 2011 on the tax treatment of gratuity and the ruling is effective from YA 2011. The determination of whether a payment is a gratuity is dependent on the facts and circumstances of each case. However, as a general rule, gratuity payments refer to lump sum payments by an employer to an employee which are attributable to the past services of the employee. Other payments, such as those attributable to the loss of employment, are treated as compensation, not as gratuity.

A lump sum payment received by an employee from his/her employer upon resignation or retirement in respect of his/her long period of service would generally be characterised as gratuity.

Gratuity is generally taxable in the hands of employees. However, an employee receiving a gratuity upon retirement would qualify for full tax exemption, subject to specific conditions.

Law: Sch 6 para 25, 25A, 25B.

Section	107A	109	109B/4A	109F/4(f)
2. Rates	<ul style="list-style-type: none"> • 10% (15% prior to 21 September 2002) of the contract payment. • 3% (5% prior to 21 September 2002) of the contract payment against tax payable by employees of the non-resident. 	<ul style="list-style-type: none"> • If no business carried on in Malaysia 15% on the gross interest, 10% on the gross royalty. • If business carried on in Malaysia Nil 	10% on the gross.	10% on the gross.
3. Reduction of rates	<ul style="list-style-type: none"> • The 10% can be reduced if the IRB is advised of the anticipated profit and loss of the whole project. • The 3% can be reduced to nil if tax information regarding the employee is provided to the Director General. 	<p>Where no business carried on in Malaysia</p> <ul style="list-style-type: none"> • Exempted if it is an approved loan, long-term loan or interest paid by a bank. • 10% tax on royalty. Lower rate if DTA is applicable. 	If within the royalty definition of the DTA, it can be reduced from 10%.	Not applicable.
4. Treatment	Advance payment of tax liability — not final tax.	<p>Where there is no business carried on</p> <p>Final tax</p> <p>Where there is business carried on</p> <p>Not a final tax</p>	Final tax, but treated as a tax set-off under s 110 if there is another source of income.	Final tax, but treated as a tax set-off under s 110 if there is another source of income.
5. Filing requirements	<ul style="list-style-type: none"> • Returns must be submitted, whether or not there is a permanent establishment. • Details of employees ensuring that their taxes are settled in full. 	<p>Where no business is carried on in Malaysia</p> <p>No returns required</p> <p>Where there is business carried on in Malaysia</p> <p>Returns are to be submitted</p>	<p>Where no other source of income derived in Malaysia</p> <p>No returns required</p> <p>Where there is source of income derived in Malaysia</p> <p>Returns are to be submitted</p>	<p>Where no other source of income derived in Malaysia</p> <p>No returns required</p> <p>Where there is source of income derived in Malaysia</p> <p>Returns are to be submitted</p>
6. Who is responsible?	Payer	Payer	Payer	Payer
7. Payment	Within 30 days of paying or crediting the payee.	Within 30 days of paying or crediting the payee.	Within 30 days of paying or crediting the payee.	Within 30 days of paying or crediting the payee.
8. Penalty	<ul style="list-style-type: none"> • Disallowance of payment in the accounts of the payer. • Recovery of money from the payer. 	<ul style="list-style-type: none"> • Disallowance of payment in the accounts of the payer. • Recovery of money from the payer. 	<ul style="list-style-type: none"> • Disallowance of payment in the accounts of the payer. • Recovery of money from the payer. 	<ul style="list-style-type: none"> • Disallowance of payment in the accounts of the payer. • Recovery of money from the payer.

INVESTMENT INCENTIVES

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INVESTMENT INCENTIVES — PROMOTION OF INVESTMENTS ACT

¶13-030 Investment incentives

The *Promotion of Investments Act 1986* (PIA 1986) and *Promotion of Investments (Amendment) Act 2007* provide a number of incentives which fall under the following headings:

- Pioneer status
- Hotel incentives
- Investment tax allowance
- Industrial adjustment allowance (withdrawn from 1 January 2008)
- Infrastructure allowance
- Abatement of adjusted income (withdrawn from YA 1993)
- Abatement of statutory income for exports (withdrawn from YA 1993)
- Export allowance (withdrawn from 1 January 2004)
- Double seductions for promotion of exports.

References to sections in this chapter will be to the PIA 1986 and not the *Income Tax Act 1967* (ITA).

¶13-040 Pertinent definitions

Section 2 of the PIA 1986 and the *Promotion of Investments (Amendment) Act 2007* provides for the following pertinent interpretations:

- “approved standard”, in relation to a hotel, means the standard as determined by the defined authority
- “contract research and development company” means a company which provides research and development (R & D) services in Malaysia only to a company other than its related company
- “defined authority” means the Minister with the concurrence in writing of the Minister of Finance
- “high technology company” means a company engaged in a promoted activity or in the production of a promoted product in areas of new and emerging technologies
- “hotel” means any accommodation, which includes a hotel, motel, chalet or hostel, of the approved standard registered with the Ministry of Culture, Arts and Tourism
- “hotel business” means the carrying on of a business in a hotel where such business provides sleeping accommodation and may include providing of food, drinks and other services or facilities and the granting of concessions of any part of such hotel for purposes connected with and incidental to the promotion of tourism
- “in-house research” means R & D carried on in Malaysia within a company for the purposes of its own business
- “integrated agricultural activity” means an activity which comprises the production of agricultural produce and the manufacturing of such

produce and includes any activity which is related and incidental to such activity

- “pioneer business” means the business of a pioneer company relating to a promoted activity or promoted product of the company which is carried on by it in its tax relief period
- “pioneer company” means a company certified by a pioneer certificate to be a pioneer company in respect of which the tax relief period has not ended or has not ceased
- “post-pioneer business” means the business of a pioneer company deemed under s 15 to have been set up and commenced on the day following the end of its tax relief period
- “pre-pioneer business” means the business of a pioneer company relating to the promoted activity or promoted product of the company which is carried on by it before the beginning of the tax relief period
- “production day” means the day specified as such in the pioneer certificate in accordance with s 7
- “promoted activity” means a manufacturing, agricultural, integrated agricultural, hotel, tourist or other industrial or commercial activity determined by the Minister in accordance with s 4 and includes the activity referred to in s 4A, 4B, 4D, 4E, 4F or 5(1A)
- “promoted product” means any product determined by the Minister in accordance with s 4 and includes the product referred to in s 4A, 4B, 4D, 4E, 4F or 5(1A)
- “research and development” means any systematic or intensive study carried out in the field of science or technology with the object of using the results of the study for the production or improvement of materials, devices, products, produce or processes, but does not include:
 - (a) quality control or routine testing of materials, devices, products or produce
 - (b) research in the social sciences or the humanities
 - (c) routine data collections
 - (d) efficiency surveys or management studies, and
 - (e) market research or sales promotion
- “research and development company” means a company which provides R & D services in Malaysia to its related company or to any other company
- “technical or vocational training company” means a company which provides technical or vocational training in Malaysia
- “tourist project” means a project, other than a hotel business, exclusively carried out for purposes connected with the promotion of tourism and registered with the Ministry of Culture, Arts and Tourism.

Law: s 2, 4, 7, 15.

¶13-045 Promoted activities and products of selected industries

Under the Promotion of Investments (Promoted Activities and Promoted Products for Selected Industries) Order 2008, the activities and products of five selected industries listed below are gazetted as promoted activities or promoted products with effect from the respective dates stated:

Industry	Activities/products	Effective date
(i) Machinery and equipment	(1) Machine tools	With effect from 20 October 2001
	(2) Plastic injection machines	
	(3) Material handling equipment	
	(4) Robotic and factory automation equipment	
	(5) Parts and components for the above (1) to (4)	
(ii) Specialised machinery and equipment	(1) Specialised or process machinery or equipment for specific industry	With effect from 21 September 2002
	(2) Packaging machinery	
	(3) Plastic extrusion machinery	
	(4) Parts and components for the above (1) to (3)	
(iii) Oil palm biomass	Utilisation of oil palm biomass to produce valued added products	With effect from 13 September 2003
(iv) Renewable energy	Generation of renewable energy	With effect from 1 October 2005
(v) Conservation of energy	Conservation of energy	With effect from 8 September 2007

The primary tax incentives available are pioneer status and investment tax allowance. However, both of these incentives are mutually exclusive and the choice of these incentives is important to ensure maximum return to the shareholders.

Law: Promotion of Investments (Promoted Activities and Promoted Products for Selected Industries) Order 2008.

PIONEER STATUS

¶13-050 Exemption from income tax

The most important advantage of acquiring pioneer status is the partial exemption (or full exemption in limited cases) from income tax for a period of five years. The status is granted to all companies participating in a promoted activity or producing a promoted product. The Minister is empowered to declare an activity or a product that can qualify for pioneer status.

No extension of the tax relief period will be granted where the application for pioneer status is received on or after 1 November 1991. In general, an extension of the pioneer period will only be applicable to a manufacturing activity or an activity relating to the treatment of water. However, where the activity or product is of national and strategic importance (including MSC companies) to Malaysia, selected industries, reinvestment in producing value-added products utilising oil palm biomass (see ¶13-218) and commercialisation of research and development findings (see ¶13-419), the Minister may grant a five-year extension.

The tax holiday of a qualifying company starts on the "production day", this being normally the day on which the company commences production of marketable quantities of the pioneer product. The Ministry of International Trade and Industry would consider that the pioneer company has commenced its pioneer business on its production day when it is producing the pioneer products at not less than 30% of its rated capacity. The pioneer company would be required to write to the Ministry for a production certificate.

Partial exemption from 1.11.1991

With effect from 1 November 1991, a company which applies for and is granted pioneer status (on or after 1 November 1991) will no longer enjoy total tax exemption. Only 70% of the statutory income from the pioneer business for each of the five years will be exempt from tax. The balance of the statutory income will be taxable at the normal corporate tax rate.

eg Example

Deanna Sdn Bhd submitted its application for pioneer status for a project in Kedah on 15 November 2008 and approval was granted on 5 December 2008. The production day was established as 11 January 2009. For the period ending 31 December 2009, chargeable income would be arrived at as follows:

Business (pioneer)	RM
Adjusted income	250,000
Less: Capital allowances	<u>(100,000)</u>
Statutory income	150,000
Less: Exemption (70% × RM150,000)	<u>(105,000)</u>
	45,000
Other income	<u>Nil</u>
Chargeable income	45,000
Tax liability RM45,000 @ 25% YA 2009	<u>11,250</u>

on interest payments. This is done by interposing an intermediary subsidiary company between the source of the income and the recipient. Netherlands Antilles or Netherlands are commonly used for such transactions to take advantage of a favourable tax treaty. In such transactions the tax authorities can require a certain spread or "turn" on the rates so as to create a small profit which is subject to tax locally.

Holding companies

Holding companies are fairly common. A holding company is formed in a tax haven and funded by a non-tax-haven company. Investments are made by the tax haven holding company and the resultant income is subject to lower or nil tax rates. Another popular method is to interpose a tax haven company between a parent and its subsidiaries which are in non-tax-haven countries. Such holding companies are sometimes referred to as "money box" companies.

Licensing

Licensing is achieved by a tax haven company holding patents, trademarks or copyrights belonging to a non-tax-haven company or multinational. The royalties received from these sources in the tax haven suffer less tax than if they were received in a non-tax-haven country.

TAX TREATY SHOPPING

¶15-900 Concept and advantage of tax treaty shopping

The expression "treaty shopping" is used to describe a situation where a person resident in a non-treaty country uses a tax treaty between two other countries. For example, A, a resident in country X, wishes to invest in country Y, but there is no tax treaty between country X and Y. Consequently, any income received by A will be fully exposed to tax in country Y. In such a situation A may find it advantageous to route his investment in country Y through country Z because a treaty exists between countries Y and Z. Successful treaty shopping transactions can result in the following:

- a reduction in source country taxation
- a low or zero rate of tax in the payee country, and
- a low or zero rate of tax on payments from the payer country to the taxpayer.

Netherlands and Netherlands Antilles are subject to a great deal of use by third country residents. A typical example is the routing of a patent licence agreement through a Netherlands holding company, with the patent holder being a Netherlands Antilles holding company and the patent user being situated in a country which has a tax treaty with the Netherlands. The royalty will be exempt from the source country withholding tax, if this is Singapore.

TAX AVOIDANCE AND TAX EVASION

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EVASION

¶16-100 Meaning of evasion

Tax resistance takes two forms: evasion and avoidance. "Evasion" is defined in the *Shorter Oxford English Dictionary* as the action of evading or escaping as by artifice or contrivance, escape, dodging, prevarication, shuffling, excuse or subterfuge. Not paying one's proper and lawful share of tax is tax evasion.

Evasion of tax is as immoral as it is illegal. Taxpayers, anywhere in the world, are inhibited by a feeling that they must save tax. But those who prefer illegitimate ways of doing this and knowingly conceal their income by falsification of returns and accounts or enter into sham transactions merely abuse the law. Such taxpayers are commonly known as tax dodgers or tax evaders.

Tax revenue is a major source of government funding; therefore, tax evasion is viewed as a serious offence in most jurisdictions, with strongly preventive laws and enforcement in place.

AVOIDANCE

¶16-200 Meaning of avoidance

"Avoidance" is defined in the *Shorter Oxford English Dictionary* as the action of avoiding anything unwelcome or shunning a person. The avoidance of tax is legitimate and denotes the taxpayer's ingenuity to arrange his/her affairs in a legal way so as to reduce the incidence of tax. So long as no provisions of the law are violated and transactions are *bona fide*, tax avoidance or the reduction of tax is justifiable. Dicta in various decided cases (*Latilla v IR Commrs*; *Levene v IR Commrs*; *IR Commrs v Duke of Westminster*; *Ayrshire Pullman Motor Services & DM Ritchie v IR Commrs*) have clearly supported the right of a taxpayer to pay only that amount of tax which he/she is obliged to pay.

On the issue of *bona fide* transactions, the objective is irrelevant. A transaction which by the acts done is in the nature of a trading transaction and is a genuine transaction and not a sham does not cease, in the absence of any statutory enactment so providing, to be a trading transaction for the purposes of income tax merely because it is entered into with the fiscal object of

recovering tax from the Revenue (*Griffiths (Inspector of Taxes) v JP Harrison (Watford) Ltd*).

The words "tax avoidance" do not necessarily indicate an unassailable hallmark of legitimacy. The real test seems to be, in any given transaction, whether the primary purpose of the transaction is to avoid tax; if it is, it is an illegal purpose, ie of such a nature that, if permitted, it would defeat the tax law in question. Such a transaction would be caught by s 140 of the *Income Tax Act 1967* (ITA). Thus, the Supreme Court in *Lim Kar Bee v Duofortis Properties (M) Sdn Bhd* (1992) 1 MSTC 3,288 decided that the contracts drawn up in respect of a scheme designed primarily to avoid estate duty were illegal.

The Duke of Westminster doctrine: form over substance

In the case of *IR Commrs v Duke of Westminster*, the House of Lords established the principle that if a document or transaction is genuine, the Court cannot go behind it to examine the underlying substance and determine the tax effect of the document or transaction based on this supposed substance. This is known as the doctrine of form over substance. The attitude of the Court in this case was based on the policy that a taxpayer is entitled, if he can, to order his affairs so that the tax attaching is less than it otherwise would be. The House of Lords indicated that there was nothing to prevent a taxpayer from attempting a tax minimisation scheme. This doctrine has rendered the task of the Revenue more difficult since the onus is on the Revenue to show that the taxpayer falls squarely and unambiguously within the scope of the charge (*Russell v Scott*).

However, in recent years, the approach of the Court has been to restrict the ambit of the Duke of Westminster doctrine, and the Court seems more inclined to look beyond the form of a transaction and at its underlying substance.

The Ramsay doctrine

In the United Kingdom, the House of Lords has developed a principle which enables the Court to consider a series of closely integrated transactions as a whole, rather than restrict itself to a consideration of each single step in isolation. On this basis, a court can conclude that as a whole an arrangement is a fiscal nullity (*Ramsay (WT) Ltd v IR Commrs; Furniss v Dawson*).

Applicability of the Ramsay doctrine in Malaysia

In the United Kingdom, unlike in Australia, Canada, New Zealand and Malaysia, there are no general anti-avoidance provisions, hence the importance of the Ramsay doctrine. In Canada, the Supreme Court has held that the Ramsay doctrine has no application there because there is a general anti-avoidance provision (*Stuart v MNR*). The Full Federal Court has similarly held that the Ramsay doctrine is not applicable in Australia because a general anti-avoidance provision already exists (*Oakey Abbatoir Pty Ltd v FC of T*). Accordingly, it is doubtful whether the Ramsay doctrine has any application in Malaysia in view of the presence of s 140.

LEGISLATION

¶16-300 Anti-avoidance provisions

Section 140 of the ITA is the main anti-avoidance section. Section 140 states:

- "(1) The Director General, where he has reason to believe that any transaction has the direct or indirect effect of—
- (a) altering the incidence of tax which is payable or suffered by or which would otherwise have been payable or suffered by any person;
 - (b) relieving any person from any liability which has arisen or which would otherwise have arisen to pay tax or to make a return;
 - (c) evading or avoiding any duty or liability which is imposed or would otherwise have been imposed on any person by this Act; or
 - (d) hindering or preventing the operation of this Act in any respect,
- may, without prejudice to such validity as it may have in any other respect or for any other purpose, disregard or vary the transaction and make such adjustments as he thinks fit with a view to counter-acting the whole or any part of any such direct or indirect effect of the transaction."

In this section, a "transaction" means any trust, grant, covenant, agreement, arrangement or other disposition or transaction made or entered into orally or in writing and includes a transaction entered into by two or more persons with another person or persons. This makes s 140 extremely wide.

It is important to note that, to be caught, a transaction needs only to be in the opinion of the Director General one that affects the incidence of tax. The Director General does not necessarily need any evidence (at least in the initial stage).

Although the words "artificial" and "fictitious" are not used in s 140, transactions of this nature will fall squarely within this section. This is simply because artificial and fictitious transactions are distinctly ones that alter the incidence of tax. The word "artificial" is an adjective in general use and is capable of bearing a variety of meanings depending on the particular context. It is a word which has a meaning quite distinct from "fictitious". A fictitious transaction is one which those who are ostensibly the parties to it never intended should be carried out — that is to say, it is a sham transaction. "Artificial", on the other hand, is descriptive of a transaction, a word of wider import. It means something which is not natural or normal, something out of the ordinary. In this context it can be said that "artificial" is not a mere synonym for "fictitious" — that is to say, one cannot be substituted for the other.

It is generally considered that, if a transaction passes the "business purpose" test or the "normality" test, it will not be deemed to be one which has the effect of avoiding tax. In other words, every transaction carried out must be

considered not only with reference to the ways and means in which it is negotiated but also with reference to the rights and obligations it has created. It follows therefore that, where a transaction has ordinary business considerations and is at arm's length, the Director General will find it difficult to invoke s 140.

The section can give immense trouble when it comes to transactions between companies in the same group where the relationship is incestuous, eg where sales between such companies are basically book transfers. Such transactions may be nothing more than "window dressings", ie shams.

With effect from 1 January 2009, s 140A is introduced to deal with the following:

- acquisition or supply of property or services between associated persons, and
- financial assistance granted between associated persons.

The provision empowers the Director General to make adjustments on transactions of goods, services or financial assistance carried out between related companies based on the arm's-length principle.

Acquisition or supply of services

Thus, where a transaction involving the acquisition or supply of property or services is not at arm's length, the Director General is entitled to determine income by substituting the price to reflect the arm's-length principle.

Provision of financial services

Where the value of financial assistance granted by a person to an associated person who is a resident is excessive in relation to the fixed capital of such person, any interest, finance charge, other consideration payable for or losses suffered in respect of the excessive portion of the financial assistance will be disallowed for tax deduction.

The financial assistance refers to that between:

- persons one of whom has control over the other
- individuals who are relatives of each other, or
- persons both of whom are controlled by some other person.

Law: s 140.

¶16-310 Transactions which alter the incidence of tax

The question whether a transaction is within the provisions of s 140 is not to be judged by the fiscal result or even the ultra-fiscal object so long as it can be said to be a commercial transaction. However, where a transaction is inspired by fiscal considerations and is so shaped that its character no longer retains the nature of a trading transaction, it can be said to be a s 140 transaction. Such a transaction takes the shape of an arrangement or a scheme which cannot be

fairly regarded as being a transaction in the relevant trade. Some of the more important factors that need to be considered are:

- What was the motive behind the transaction?
- Was the transaction in the ordinary course of the trade or business? That is to say, was the purchase or sale made in "what is truly the carrying on" of the business of the taxpayer?
- Was the transaction merely one to secure a fiscal advantage?
- Was the seller of the property the head and brain of the buyer of the property? Putting it another way, was the buyer in effective and constant control of the seller?
- Was the loss incurred in the course of the trade of the taxpayer?
- Did the purchaser have any options in the transaction contemplated?

There have been several cases in Malaysia and Singapore on transactions which alter the incidence of tax payable. The more important ones are summarised below:

Malaysia

- *CIT v AB Estates Ltd* (1950–1985) MSTC 95

The taxpayer company acquired a rubber estate and leased it to a subsidiary far below the fair rental at that time. The Federal Court held that the lease was not a transaction in the ordinary course of business and consequently the transaction was artificial. The transaction had not been motivated by economic consideration and was thus unnatural and artificial.

- *LD Timber Sendirian Berhad v DGIR*

The taxpayer signed two agreements; one for timber extraction and the other for the sale of timber and the execution of certain works on the same day. The intention was to separate the income derived from the extraction of timber and the income from the sale of timber with the result that the company would escape liability for timber profit tax on the income derived from the sales of those timbers; but not the income from timber extraction fees.

The Court applied the test in *Newton v FC of T*, ie if the transactions are capable of explanation by reference to ordinary business or family dealing, without necessarily being labelled as a means to avoid tax, then the arrangement is not caught by the tax-avoidance section. The arrangement adopted by the company had been an ordinary business dealing.

- *SB Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri* (1995) 2 MSTC 2,417

The taxpayer, a commercial company, having been informed of the controlling body's wish that all surplus funds be donated to the controlling body, decided to donate its profits rather than declare dividends, to its controlling body, a non-profit making institution. The Special Commissioners held that the method adopted by the taxpayer had the effect of altering the incidence of tax which would otherwise