

Examiner's report

P6 Advanced Taxation (MYS)

June 2015



General Comments

The examination comprises 2 sections. Section A contained two compulsory questions: question 1 for 35 marks and question 2 for 25 marks. Section B required a response to two out of three questions of 20 marks each.

Most candidates attempted the required four questions, and there was no evidence of time pressure.

Candidates performed relatively well on questions 3 and 5. The question candidates found most challenging was question 4. Answers to question 1 and question 2 were of mixed quality. This was mainly due to candidates not being able to apply their understanding of the fundamental tax principles sufficiently well.

A number of common issues arose in candidates' answers as follows:

- Failing to directly respond to the question requirement and instead providing general features of the technical topic, which scored few if any marks.
- Venturing into related but untested issues – for example:
 - when answering about the deductibility of interest expenses, many candidates automatically discussed the issue of “interest restriction” which was irrelevant;
 - in commenting about unabsorbed losses and capital allowance, many candidates wrote about eligibility for group relief, which was not relevant to the scenario

Specific Comments

Question One

This 35-mark question was based on an investment holding company, Planet, contemplating two options under which to acquire a manufacturing business operated by an unrelated company, Sun. The options were: 1) to acquire the entire share capital of Sun, or 2) to acquire the assets and liabilities of Sun's manufacturing business. To finance the acquisition, Planet would borrow from a Malaysian commercial bank and from its non-resident parent company. Candidates were required to prepare a letter to Planet to advise on the relative tax treatment of each option and to suggest some tax planning ideas.

Part (i), for two marks, required the identification of the type of income derived under each option. This was relatively well answered, although there were some candidates who missed the point being tested.

In Part (ii) pertained to the tax deductibility of interest expense under each option. A surprising number of candidates commented that the interest expense on a loan from a non-resident company or on a loan taken to invest in capital assets was not tax deductible. Such statements are, *per se*, incorrect. Additionally, many candidates discussed interest restriction and its mechanism, which is irrelevant in this context.

Part (iii) asked about transfer pricing issues. Many candidates regurgitated whole passages from the suggested solutions to an earlier exam question on transfer pricing, which were not relevant in the present context. Candidates are strongly discouraged from rote learning and giving stock answers: they should understand the principles so that they can apply them correctly to the specific scenario being tested.

Part (iv) on the trade receivables and inventory of Sun was reasonably answered, although frequently not succinctly enough and with unnecessary meandering through the subject matter, which would have wasted valuable time that could have been better spent elsewhere.



Part (v) tested how the unabsorbed capital allowances and losses accumulated under Sun's manufacturing business from prior years would be treated under each option. Many candidates correctly stated the tax treatment when Sun continued to operate the manufacturing business. However, many were not clear that such unabsorbed balances from prior years could not be transferred to Planet if it took over the manufacturing business (i.e. acquired the assets rather than the shares). This is an example of how candidates could not apply their knowledge of a basic tax principle to a given scenario. Some candidates even discussed the possibility of group relief, which was not possible since these are brought forward balances rather than current year losses.

Part (vi) invited candidates to calculate the comparative tax position under each option. While many candidates scored well here, a sizeable number of candidates were unsure of fundamental principles.

Part (vii) called for tax planning ideas/advice. Despite identifying the interest rate, trade receivables and inventory as the relevant areas, some candidates still were unable to respond correctly.

As regards professional marks, a surprising number of candidates did not provide the comparative computations in an appendix, separate from the main body of the letter.

Question Two

This 25-mark question featured an additional assessment after a tax audit which denied tax deduction to four expense items. Candidates were required to present arguments for the deductibility of these items, to comment on the penalty imposed for incorrect return and also on the procedure for a late appeal.

Part (a) (i) was about the treatment of a catering expense in connection with a product launch. Candidates tended to miss the central point that while the food and beverage were undeniably caught as an entertainment expense, a product launch is included in one of the provisos (exceptions), i.e. entertainment expense "related wholly to sales", which treatment was confirmed in the Public Ruling on entertainment expenses.

Part (a)(ii) pertained to the payment of commission to a non-resident for business introductions. Many candidates again missed the point that this was neither technical service fee nor "other income" because the facts clearly indicated that the commission constituted business income of the non-resident. This should have led to the conclusion that there was no failure to comply with the withholding tax provisions and therefore the commission payment should not be denied a tax deduction. Candidates' unsatisfactory performance here is unlikely to be an issue of a lack of technical knowledge as, it is considered likely that, if the question asked had been: "Given the facts, state whether withholding tax is applicable", candidates would have been able to answer. Candidates must take note that, at the professional level, it is imperative they know how to "apply" their tax knowledge to given scenarios.

Part (a)(iii) dealt with a repair and maintenance expense. This was generally well answered and candidates were able to differentiate between the replacement of parts and the entire asset.

Part (a)(iv) concerned the expense incurred on the testing of improved features of existing products. Many candidates could discern the difference between the improvement of existing products and developing new products.

Part (b) regarding the penalty for an incorrect return was not satisfactorily answered. Most candidates talked about the penalty for late submission, completely missing the incorrect return issue. This was clearly due to a failure to read the requirement with due care.

Part (c) related to an application for an extension of time to lodge an appeal against the additional assessment and was unsatisfactorily answered. Most candidates did not realise the significance of the postal delay and that

on the day of the exam i.e. 5 June 2015, the 30 days for an appeal had already lapsed. It appears that many candidates did not know about the application for an extension of time to appeal against an assessment.

Question Three

This 20-mark question tested the change of accounting date by a trading company, Best, and presence of a permanent establishment (PE) in China by virtue of its placement of an employee, Miss Rajin, in China for 24 months and the tax position of Rajin.

The change of accounting date part was satisfactorily answered. This was a purely technical question which many candidates should have been able to tackle well. However, many candidates failed to maximise their marks as they did not offer the reasons or the underlying principles for the basis periods, despite the wording of the requirement.

The determination of whether there was a PE in China in part (b) was well answered. However, many candidates did not explain how double taxation occurs in part (c). Many candidates were not well versed with the source rules relating to business or employment income.

The residence status of Rajin in part (d) was well answered, with many correctly concluding that Rajin was resident for all the relevant years despite her 24-month time in China. This shows that candidates were able to apply their knowledge to the given scenario.

Question Four

This 20-mark question was based on a trust set up through a donation from an artist to provide essential services to the homeless at much reduced consideration. This tested the fundamental principles relating to “income”, “business”, “classification of income”, “deductions”, and included six marks for the computation of chargeable income of the trust.

The vast majority of candidates did not choose to answer this question, presumably avoiding it due to the inclusion of a trust in the scenario. This was another indication that candidates are not well prepared in applying basic tax principles.

The candidates who did attempt question 4 did so satisfactorily.

Question Five

This 20-mark question examined the reinvestment allowance with a small focus on the 36-month requirement. Candidates were required to state the eligibility criteria, how they were satisfied by ABC Sdn Bhd and advise as to how to maximise the claim for the allowance, the clawback on early disposal, and whether the company had become a real property company (RPC) at any time.

This question was fairly well answered except for the following points which were missed by many candidates:

- (i) The 36-month period starts from the commencement of operations, not the date of incorporation;
- (ii) The 36 months period is to be counted up to the date the qualifying capital expenditure is incurred;
- (iii) It is necessary to ascertain the RPC status when a non-RPC company “acquires” real property or RPC shares;
- (iv) Incurring enhancement costs, such as building a factory, on land already owned by the company is not tantamount to “acquiring” real property. Therefore it does not trigger the need to determine the RPC status by reference to the 75% rule.

Conclusion



Candidates must ensure that they fully understand the tax subject matter, and their preparation must also focus on the application of the technical rules learned.