

Examiner's report

P6 (MYS) Advanced Taxation

June 2017



General Comments

The examination consisted of two sections. Section A contained Q1 for 35 marks and Q2 for 25 marks, both questions being compulsory. Section B contained three questions of 20 marks each, from which candidates had to answer two questions.

The vast majority of candidates attempted all four questions, and there was little evidence of time pressure. Where questions were left unanswered by candidates, this appeared to be due to a lack of knowledge or poor exam technique, as opposed to time pressure.

Specific Comments

Question One

This 35-mark question was based on a garment manufacturer undertaking projects of diversification and backward integration. It tested candidates' knowledge of the reinvestment allowance (RA), the capital versus revenue issue of replacement of parts of assets, compensation payment, income tax deductibility of input tax, GST, and tax computation.

Parts (i) and (ii) together for eight marks required candidates to determine the company's eligibility for RA and whether Projects A and B constituted qualifying projects and the timing of the claim. Many candidates wrote at length about all they knew about RA: the eligibility requisites, set off against 70% and credit to exempt account and carry forward of unabsorbed RA. They overlooked the timing aspect, i.e.

- that the company could enjoy RA only for 15 years from YA 2001,
- that there is an extension of three years,
- that the capital expenditure on the factory is deemed incurred only on completion, and
- that for machinery on hire purchase, only the capital portion paid up qualified for RA.

While still on RA, many candidates also did not correctly identify Project A as "diversification" and Project B as "backward integration" despite the facts being quite clear about diversifying into men's garments and going upstream to produce the raw materials. Candidates tended to think only of "expansion".

Part (iii) for nine marks tested very fundamental tax principles of replacement of part or whole, whether there was enhancement to render it as capital in nature, and whether a compensation payment to a would-be competitor is capital or revenue in nature. This was generally well-answered.

Part (iv) required candidates to explain whether input tax borne on the chimney construction and light bulbs was deductible for tax purposes. Part (v) asked whether the compensation payment to the competitor was subject to GST. Candidates did not appear to have grasped GST well.

Overall the performance on the question was not satisfactory.

Question Two

Parts (a) and (b) together tested all aspects of the listed investment holding company (IHC).

While the tax status of the company was well understood, the tax computation required in part (b) was not well done.

The aspects which created difficulty were:

- That as the investment income from dividend and interest was to be treated as separate business sources and therefore the common expenses, interest and capital allowances were also to be separately attributed,
- That management fees were to be treated as a genuine business, and not as a source under section 4(f),
- That the loss from the interest source was not allowable, while the loss from the genuine business source was allowable against statutory income from all businesses (including deemed business).

Part (c) for six marks dealt with a company buying back its own shares from the open market to meet its ESOS obligations. Many candidates performed well, regarding the capital nature of its initial buy-back and subsequent sell-back.

However, as regards the application of the treasury shares to meet ESOS obligations, many candidates did not bring out the point that the cost of such shares was deductible because of specific legislation. Instead, they wrote about the tax treatment of such shares in the hands of the employees, which was not relevant in this instance.

Question Three

This 20-mark question set the scenario of a foreign enterprise contemplating doing business in Malaysia and tested the topics of permanent establishments (PE), and the comparative tax treatment of a branch and a locally-incorporated company.

Part (a) on whether there was a PE in Malaysia for two years of assessment was well responded to, and candidates demonstrated they had a clear understanding of the PE concept.

Part (b) regarding the comparative treatment of a branch and a subsidiary was really a test of fundamental principles of

- tax deductibility of business expenses,
- eligibility for capital allowance in general and for small value assets in particular,
- application of withholding tax,
- tax rates, and
- the tax implications of the distribution of profits.

This part, which carried 16 marks, was generally well answered.

Question Four

Part (a) of this 20-mark question related to an individual starting up a business while also deriving income from overseas. It tested the determination of commencement of business, basis period of an individual, eligibility for industrial building allowance (IBA) by owner and tenant, and the scope of charge.

Out of the above topics only the commencement of business was well attempted. Many candidates were not aware that individuals can only have a basis period made up of the calendar year. They were also not aware of the fact of the tenant having a relevant interest over a rented building by virtue of the capital expenditure incurred by him. They were also equally unaware of the eligibility for IBA by the owner of a building if the building was used as an industrial building by her tenant.

Part (b) tested the statutory time bar in the context of additional assessments issued after a tax audit.

Most candidates performed satisfactorily. One point was omitted though: that the time bar did not apply if there was fraud, wilful default or negligence. Some candidates still alluded to the defunct "7 years", rather than the current 5 years time bar.

Question Five

This 20-mark question tested the tax treatment of premium and rental in relation to a lease of land, from the perspective of the land owner and the lessee. It also tested the real property gains tax (RPGT) treatment of a sub-lease.

Part (a) for five marks required an appreciation of the payment of a premium to secure a right to use the land over a period and the payment of annual rent for the use of the land. It boiled down to the capital versus revenue issue.

Parts (b) and (c) related to the treatment of the sub-lease and the computation of RPGT. Many candidates did not take account of the lapsed period of the lease to correctly determine the acquisition price of the lease, but most were able to correctly set off the allowable loss.

Part (d) dealt with the tax treatment of the premium and the annual rent from the recipient's perspective. Apart from the issue of capital versus revenue, which was not clearly argued by many candidates, the issue of rental received in advance was adequately responded to.