

THE TAXATION OF INCOME FROM REGIONAL HUBS

RELEVANT TO ACCA QUALIFICATION PAPER P6 (MYS)

Operational headquarters companies (OHQs), regional distribution centre companies (RDCs), and international procurement centre companies (IPCs) are covered by the *Study Guide* for Paper P6 (MYS) in item A2(c)(xii). Each is covered by a separate PU Order, but as they have many similarities it is convenient to deal with all of them in one article.

OPERATIONAL HEADQUARTERS COMPANY – OHQ

An OHQ is a company operating in Malaysia which provides qualifying services and which is approved by the Minister of Finance. The types of services provided by an OHQ that may qualify as qualifying services include general management and administration, business planning and coordination, marketing control and sales promotion planning, training and personnel management, and treasury and fund management services. The full list of qualifying services is available on the Malaysian Industrial Development Authority (MIDA) website. Candidates are not required to memorise these. However, they do need to know the meaning of certain statutory expressions and these are detailed in this article.

The exemption

This is a two-part exemption. One part consists of statutory income from the provision of qualifying services and is fully exempt. The other part consists of the provision of services in Malaysia, and for this part, the statutory income is exempt subject to an overall limit based on 20/80ths of the gross income from the provision of qualifying services. The amount exempted is credited to an exempt income account from which two-tier exempt dividends can be distributed. This should not be dismissed out of hand because many companies will continue to pay taxed dividends out of non-exempt income throughout the period of transition to the single-tier system. Non-exempt income from the provision of services in Malaysia, and business income other than that from the provision of services, is liable to tax.

Method of calculating exempt income

Qualifying services

No further calculation is required since the statutory income from the provision of qualifying services is fully exempt.

Services in Malaysia

Exempt statutory income from the provision of services in Malaysia is determined by the following formula:

$$\frac{A \times C}{B}$$

Where:

A is the amount determined according to the following formula:

$$\frac{20}{80} \times \text{amount of gross income from the provision of qualifying services}$$

B is the amount of gross income from the provision of services in Malaysia

C is the amount of statutory income from the provision of services in Malaysia.

TECHNICAL

Exempt period

So long as the OHQ continues to comply with whatever conditions are specified by the Minister when granting approval, the exemption can be enjoyed for a period of 10 years of assessment, commencing from the year in the basis period for which the approval is granted.

EXAMPLE 1

PusatAdmin Sdn Bhd ('PusatAdmin'), is a company which was approved as an OHQ on 1 May 2007. In order to claim the incentive, PusatAdmin must fulfil the requirement that its total operating expenditure be at least RM1.5m per year. PusatAdmin closes its accounts on 30 June each year. The following information relates to the operating expenditure of PusatAdmin for the relevant years:

Year ended	Operating expenditure RM millions
30 June 2007	2.0
30 June 2008	1.4
30 June 2009	1.5

In 2008, the company undertook cost-cutting measures due to poor economic conditions. All other conditions specified upon approval were fulfilled.

Required

State the years of assessment for which PusatAdmin may enjoy the incentive available to an approved OHQ, and the year(s) of assessment in which PusatAdmin cannot claim the exemption, giving a brief explanation.

Suggested solution

The exemption is available for a period of 10 years of assessment from the year of assessment in which the approval is granted. PusatAdmin was approved as an OHQ on 1 May 2007, which falls in the year of assessment 2007. Therefore, PusatAdmin may enjoy the incentive for the years of assessment 2007 to 2016 inclusive. However, PusatAdmin cannot claim the exemption for the year of assessment 2008 because its operating expenditure was below RM1.5m.

Other important definitions for the purpose of this exemption

- Qualifying services are services provided by an OHQ to at least three of its offices outside Malaysia or to its related companies outside Malaysia in respect of services as specified by the Minister (see above). It is clear from the words used that the services may be provided to a company's branches abroad as well as to its related companies.
- Services in Malaysia are services provided by an OHQ to a related company in Malaysia in respect of services as specified by the Minister.
- 'Related company' has the same meaning as under Section 2 of the Promotion of Investments Act 1986. Therefore, the term related company, when referring to a particular company, means one:
 - in which the operations are or can be controlled, either directly or indirectly, by the particular company
 - which controls or can control, either directly or indirectly, the operations of the particular company, or
 - in which the operations are or can be controlled, either directly or indirectly, by a person or persons who control or can control, either directly or indirectly, the operations of the particular company.

Note: A company is also deemed to be a related company of a particular company if:

- at least 20% of its issued share capital is beneficially owned, either directly or indirectly, by the particular company, or
- at least 20% of the issued share capital of the particular company is beneficially owned, either directly or indirectly, by the first mentioned company.

The definition of a related company is important because, in order for services provided to any company by an OHQ to be treated as qualifying services or as services in Malaysia, the company receiving the services must be a related company. As explained above, the relationship between companies may be determined by either the nature of its operational control or by the ownership of at least 20% of its issued share capital.

Limitations

There are some restrictions during the exemption period, which are:

- The OHQ company is treated as having three separate and distinct sources of business income: income from the provision of qualifying services, income from the provision of services in Malaysia, and income from other businesses. Since all of the deemed businesses usually operate from the same office, common deductible expenses and common capital allowances may have to be apportioned in order to determine the statutory income of each business. Any 'just and reasonable' method should be acceptable. In exam questions, candidates can expect to be given guidance on the method of apportionment to be used.
- In arriving at the statutory income of the exempt businesses (both qualifying services and services in Malaysia), Schedule 3 capital allowances must be deducted. This mandatory capital allowance deduction is similar to the capital allowance treatment for a pioneer company during the tax relief period.
- Any adjusted loss from the provision of qualifying services, whether for the current year or prior years, is disregarded for the source relating to the provision of services in Malaysia and for the source consisting of other businesses.
- Any unabsorbed loss from the provision of qualifying services is disregarded at the end of the exempt period and cannot be carried forward to the subsequent year of assessment.

EXAMPLE 2

PowerQ Sdn Bhd makes up its accounts to 31 March each year

TABLE 1: POWERQ SDN BHD ACCOUNTS – YEARS OF ASSESSMENT 2008 AND 2009

Year of assessment	2008			2009		
	Gross income RM'000	Adjusted income RM'000	Capital allowances RM'000	Gross income RM'000	Adjusted income RM'000	Capital allowances RM'000
Qualifying services	1,000,000	700,000	200,000	1,500,000	840,000	235,000
Services in Malaysia	400,000	300,000	30,000	350,000	240,000	42,000
Other business	200,000	125,000	25,000	240,000	150,000	30,000

and has been an approved OHQ since 1 April 2006. All the conditions specified upon its approval have been fulfilled. The information in **Table 1** is for the years ended 31 March 2008 and 31 March 2009.

Other information:

- 1 Cash donations to approved S44(6) institutions for the year of assessment 2008 are RM12,000
- 2 Non-exempt interest income received for the year of assessment 2008 is RM2,000.

Required

Compute the chargeable income of PowerQ Sdn Bhd for the years of assessment 2008 and 2009.

Suggested solution

PowerQ Sdn Bhd – Tax computation

	Qualifying services RM'000	Malaysia RM'000	Other Business RM'000	RM'000
Year of assessment 2008				
Adjusted income	700,000	300,000	125,000	
Less : Capital allowances	(200,000)	(30,000)	(25,000)	
Statutory income before exemption (C)	500,000	270,000	100,000	
Less: Exemption (Note 1)	(500,000)	(168,750)		
Statutory income after exemption	0	101,250	100,000	201,250
Add: Interest income				2,000
Aggregate income				203,250
Less: Approved donation (7% of aggregate income = RM14,227; not restricted)				(12,000)
Chargeable income				<u>191,250</u>
Year of assessment 2009				
Adjusted income	840,000	240,000	150,000	
Less: Capital allowances	(235,000)	(42,000)	(30,000)	
Statutory income before exemption (C)	605,000	198,000	120,000	
Less: Exemption (Note 2)	(605,000)	(198,000)		
Statutory income after exemption	0	0	120,000	120,000
Chargeable income				<u>120,000</u>

Note 1: Income from services in Malaysia exempted in year of assessment 2008:

(a) Numerator (A):

$$\frac{20}{80} \times \text{gross income from qualifying services}$$

$$= \frac{20}{80} \times \text{RM1m} = \text{RM250,000}$$

(b) Statutory income from services in Malaysia exempted:

$$= \frac{\text{A}}{\text{Gross income from services in Malaysia (C) in Malaysia (B)}} \times \text{Statutory income from services in Malaysia (C)}$$

$$= \frac{\text{RM250,000}}{\text{RM400,000}} \times \text{RM270,000}$$

$$= \text{RM168,750}$$

Note 2: Income from services in Malaysia exempted in year of assessment 2009:

(a) Numerator (A):

$$\frac{20}{80} \times \text{gross income from qualifying services}$$

$$= \frac{20}{80} \times \text{RM1,500,000} = \text{RM375,000}$$

(b) Statutory income from services in Malaysia exempted:

$$= \frac{\text{A}}{\text{Gross income from services in Malaysia (C) in Malaysia (B)}} \times \text{Statutory income from services in Malaysia (C)}$$

$$= \frac{\text{RM375,000}}{\text{RM350,000}} \times \text{RM198,000}$$

= RM212,142 – as this is greater than RM198,000, the statutory income from services in Malaysia is fully exempt.

REGIONAL DISTRIBUTION CENTRE COMPANY – RDC - AND INTERNATIONAL PROCUREMENT CENTRE COMPANY – IPC

An RDC or IPC is a company, or a division of a company, incorporated in Malaysia, which provides qualifying activities, and which is approved by the Minister upon the fulfilment of specified conditions. Although provided under separate gazette orders, the exemptions for an RDC and an IPC are exactly the same. The distinction between an RDC and an IPC lies in its activities. An RDC focuses on the logistics of a company's output, whereas an IPC focuses on the logistics of the company's input. In particular, the qualifying activities for an RDC are those it undertakes as a collection and consolidation centre for any finished products, components, and spare parts produced by its related companies for its own brands, from within or outside Malaysia, which are then distributed to related and unrelated companies within or outside Malaysia. The qualifying activities for an IPC are those undertaken in respect of the procurement and sale of raw materials, components, and finished products from related and unrelated companies to related and unrelated companies within or outside Malaysia.

The exemption

The statutory income of an RDC and an IPC is exempted as follows:

- Statutory income from qualifying activities in relation to direct export sales is fully exempted.
- Statutory income from qualifying activities in relation to drop shipment export sales is exempted, subject to an overall limit based on a proportion (30/50ths) of direct export sales.

TECHNICAL

- Statutory income from qualifying activities in relation to local sales is exempted up to a limit based on a proportion (20/80ths) of eligible direct export and drop shipment export sales.

The total amount exempted is credited to an exempt income account from which two-tier exempt dividends can be distributed. As with the OHQ exemption, when the statutory income from drop shipment export sales or local sales exceeds the exemption available, the excess is liable to tax.

Method of calculating exempt income

Direct export sales

The statutory income from qualifying activities in respect of direct export sales is fully exempted. Since the direct export sales, drop shipment export sales, and local sales are not treated as separate business sources, a calculation is still required to identify which part of the statutory income is attributable to direct export sales. The gazette order does not explicitly specify the formula required to calculate the exempted amount for direct export sales. Candidates are advised to use the following method, which is consistent with the formulae specified for drop shipment export sales and local sales:

$F \times C$	Year ended	Local sales	Drop shipment export sales	Direct export sales
B	30 June 2003	RM millions	RM millions	RM millions
	30 June 2004	35	35	20
	30 June 2005	35	45	40
Where:	30 June 2006	55	25	50
F is the value of the direct export sales	30 June 2007	70	20	50
B is the value of the sales from all qualifying activities	30 June 2008	55	45	60
C is the amount of the statutory income from all qualifying activities.		49	50	51

Drop shipment export sales

The amount of statutory income for drop shipment export sales which is exempted is determined as follows:

$$\frac{A \times C}{B}$$

Where:

- A is the lower of either
 $\frac{30}{50}$ x the value of direct export sales, or the value of drop shipment export sales
 B is the value of sales from all qualifying activities
 C is the amount of statutory income from all qualifying activities.

Local sales

The amount of statutory income for local sales which is exempted is determined as follows:

$$\frac{D \times C}{B}$$

Where:

- D is the lower of $\frac{20}{80}$ x the value of direct export sales plus the value of A (E),
 or the value of local sales
 B is the value of all sales from qualifying activities
 C is the amount of statutory income from all qualifying activities.

Exempt period

The exemption for an RDC or IPC is available for a period of 10 years of assessment which commences with the earlier of either:

- the year of assessment in the basis period for which the company achieves the following annual free-on-board sales value in respect of qualifying activities for a year of assessment:

- total sales of RM100m
- export sales of RM80m and
- direct export sales of RM50m

or

- the fourth year of assessment from the year of assessment in which the approval was granted.

Similar to an OHQ, an RDC or IPC can only enjoy the exemption in a particular year of assessment when the conditions specified upon approval are fulfilled. In the event that the sales are not recorded using the free-on-board value (using the ex-factory price for example), candidates need to convert the figures to the free-on-board value before checking the threshold.

EXAMPLE 3

The logistics division of NanoTech Sdn Bhd ('NanoTech'), was approved by MIDA on 1 May 2003 as an IPC. NanoTech closes its accounts on 30 June each year. The annual sales values of the logistics division for the relevant years are:

Year ended	Local sales RM millions	Drop shipment export sales RM millions	Direct export sales RM millions
30 June 2003	35	35	20
30 June 2004	35	45	40
30 June 2005	55	25	50
30 June 2006	70	20	50
30 June 2007	55	45	60
30 June 2008	49	50	51

Sales are recorded at the free-on-board value and all transactions with related parties are recorded at market price.

Required

State the year of assessment in which the exempt period commences, and the first year of assessment in which NanoTech can claim the exemption, giving a brief explanation.

Suggested solution

The exempt period commences on the first day of the basis period for the year of assessment 2006. This is because the exempt period would have to commence with the fourth year of assessment from the year of assessment in the basis period for which the approval was granted, irrespective of the fact that the export sales of NanoTech are below the minimum specified.

The year of assessment 2007 is the first year in which NanoTech can claim the exemption because it is only in the basis period for that year that total sales, export sales and direct export sales are at least RM100m#, RM80m# and RM50m# respectively for the first time.

Year ended	Local sales (a) RMm	Drop shipment export sales (b) RMm	Direct export sales (c) RMm	Export sales (b) + (c) RMm	Total sales (a) + (b) + (c) RMm
30 June 2003	35	35	20	55	90
30 June 2004	35	45	40	85	120
30 June 2005	55	25	50	75	130
30 June 2006	70	20	50	70	140
30 June 2007	55	45	60*	105*	160*
30 June 2008	49	50	51	101	150
Minimum sales			50	80	100

Other important definitions:

- Export sales are sales made by an RDC or IPC (in respect of qualifying activities) to related and unrelated companies outside Malaysia. There are two types of export sales:
 - direct export sales – export sales to related and unrelated companies outside Malaysia via shipment from within Malaysia but not including sales to Free Zones and Licensed Manufacturing Warehouses
 - drop shipment export sales – export sales to related and unrelated companies outside Malaysia via shipment from outside Malaysia.
- Local sales are sales made by an RDC or IPC (in respect of qualifying activities) to related and unrelated companies within Malaysia, including sales to Free Zones and Licensed Manufacturing Warehouses.
- The annual value of export sales is the free-on-board value of the direct export sales and drop shipment export sales.
- 'Related company' has the same meaning as under Section 2 of the Promotion of Investment Act 1986, as discussed earlier in this article relation to OHCs.
- The qualifying activities and other businesses are treated as separate and distinct sources of income. Candidates should note that for an IPC or RDC, all three qualifying activities are treated as one source, unlike the case of an OHQ, where the two types of qualifying activity are treated as separate and distinct sources.
- Adjusted losses and unabsorbed losses in respect of qualifying activities cannot be set off against the income from other business sources.
- At the end of the exemption period, any unabsorbed losses from qualifying activities cannot be carried forward to the subsequent year of assessment.
- If an RDC or IPC operates as a division of a company incorporated in Malaysia, any sales or procurement transactions to or from other divisions of that company, or to or from other related companies, must be at market price. 'Market price' is the price that would be charged if such transactions were made between independent entities under similar circumstances. Proper documentation is crucial so that an RDC or IPC can prove that its transactions are at market price.

Limitations

Most of the limitations applicable to an RDC or IPC are similar to those for an OHQ:

- In arriving at the statutory income from the exempt business, Schedule 3 capital allowances must be deducted.

EXAMPLE 4

Halal Food Sdn Bhd makes up accounts to 31 January each year. Halal Food Sdn Bhd is an RDC where all the conditions specified upon approval have been fulfilled. The following information is for the year ending 31 January 2009.

TECHNICAL

	RM'000	
Qualifying activities		$\frac{30}{50}$ x value of direct export sales
Sales		
Direct export sales	1,150,000	$= \frac{30}{50} \times \text{RM}1,100,000 = \text{RM}660,000$
Drop shipment export sales	700,000	
Local sales	350,000	
Adjusted income	668,000	<input type="checkbox"/> Value of drop shipment export sales = RM700,000
Capital allowances	28,000	
Unabsorbed losses brought forward	5,000	A is RM660,000
Other business		(b) Statutory income of drop shipment export sales exempted:
Statutory income	100,000	$= \frac{A}{\text{Value of all sales from qualifying activities (B)}} \times \text{Statutory income from all qualifying activities (C)}$
Unabsorbed losses brought forward	7,000	
Interest income	3,000	
Other information:		
1 The sales are recorded at free-on-board value.		$= \frac{\text{RM}660,000}{\text{RM}2,200,000} \times \text{RM}640,000$
2 All transactions to related companies are at market value.		
3 Direct export sales included sales to a Licensed Manufacturing Warehouse of RM50m.		$= \text{RM}192,000$
4 Zakat of RM8m was paid in the year of assessment 2009.		

Required

Compute the chargeable income of Halal Food Sdn Bhd for the year of assessment 2009.

Suggested solution

Halal Food Sdn Bhd – Tax computation for year of assessment 2009

	RM'000	
Qualifying activities		
Adjusted income	668,000	
Capital allowances	<u>(28,000)</u>	<input type="checkbox"/> the value of local sales = RM350,000 + RM50,000 = RM400,000
Statutory income before exemption (C)	640,000	E is RM400,000
Less: Exemption		D is RM100,000
Direct export sales (Note 1)	(320,000)	
Drop shipment export sales (Note 2)	(192,000)	(b) Statutory income of local sales exempted:
Local sales (Note 3)	<u>(29,091)</u>	$= \frac{D}{\text{Value of sales from all qualifying activities (B)}} \times \text{Statutory income from all qualifying activities (C)}$
Statutory income after exemption	98,909	
Statutory income from other business	<u>100,000</u>	$= \frac{\text{RM}100,000}{\text{RM}2,200,000} \times \text{RM}640,000$
Statutory income from all business sources	198,909	$= \text{RM}29,091$
Less: Unabsorbed losses (RM5,000 + RM7,000) (Note 4)	<u>(12,000)</u>	
	186,909	Note 4: The unabsorbed loss incurred on qualifying activities in previous years is to be disregarded in relation to other business activities. However, as there is a sufficient amount of statutory income from qualifying activities to be set off for the current year from such activities, no restriction is needed. ■
Interest income	3,000	
Aggregate income	<u>189,909</u>	
Less: Zakat perniagaan RM8 million unrestricted as not exceeding 2.5% of aggregate income	<u>(8,000)</u>	
Chargeable income	<u>181,909</u>	

Note 1: Direct export sales: statutory income exempted
 $= \frac{\text{Value of direct export sales}}{\text{Value of sales from all qualifying activities (B)}} \times \text{Statutory income from all qualifying activities (C)}$

$$= \frac{\text{RM } 1,150,000 - \text{RM}50,000}{\text{RM}1,150,000 + \text{RM}700,000 + \text{RM}350,000} \times \text{RM}640,000$$

$$= \text{RM}320,000$$

Note 2: Drop shipment export sales

(a) Numerator (A):

the lower of:

REFERENCES

- Income Tax (Exemption) (No. 40) Order 2005 PU(A) 307/2005, as amended PU(A)260/2007.
- Income Tax (Exemption) (No. 41) Order 2005 PU(A) 308/2005, as amended by PU(A) 261/2007.
- Income Tax (Exemption) (No. 42) Order 2005 PU(A) 309/2005, as amended by PU(A) 262/2007.

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