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Tax Espresso
A snappy delight

Greetings from Deloitte Malaysia's Tax services group

Tax Case

Maxis Communications Berhad (Maxis) v Director General of Inland Revenue (DGIR) - Federal Court

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Public Ruling No. 7/2014: Unit Trust Funds Part II –

Maxis launched its Employees Share Option Scheme (ESOS) when it was listed on Bursa Malaysia. Eligible employees were granted options to subscribe for shares in Maxis through ESOS. The options were granted by way of a letter of offer from Maxis to an eligible employee. Upon receipt of the letter of offer, an eligible employee would decide whether to accept the offer or not. If the eligible employee accepted the offer, he or she would sign an acceptance form referred to as the "Share Option Agreement".

The signed acceptance form specified the number of shares accepted, the price per share, the total amount payable and payment of RM1.00 resulting in a binding contract. The options vested one-third (1/3) on each anniversary (over a three year period) from the date of the offer. An eligible employee could exercise the option up to ten (10) years from the date of the first grant.

On 24 May 2007, Binariang made a Conditional Take-over to acquire all voting shares in Maxis for a cash consideration. By reason of the Take-over and the request of Binariang, the Board of Directors of Maxis invoked clause 10 of the ESOS By-laws where the holders of the unvested option were entitled to a payment of Equivalent Cash Consideration (ECC) in accordance with the vesting schedule of such unvested option. Under the ECC, the employees received an alternative consideration in substitution or in cancellation of all outstanding unvested options. The cash amount would only be paid to them in tranches according to the original vesting schedule applicable to the outstanding options.

Issue

The issue to be decided in this case involved the question of how eligible employees were to be assessed for tax for cancellation of all outstanding unvested option in return for the

Important deadlines:

Due date for 2016 tax estimates for companies with January year-end (1 January 2015)

6th month revision of tax estimates for companies with June year-end (31 December 2014)

9th month revision of tax estimates for companies with March year-end (31 December 2014)

Statutory filing of 2014 tax returns for companies with May year-end (31 December 2014) payment of the ECC.

Decision

The Federal Court affirmed the decision of the Court of Appeal that the cash benefit received (ECC) was not taxed in accordance with Sections 25(1A) and 32(1A) of the Income Tax Act 1967 (ITA), but instead, was taxable under Section 25(1) of the ITA based on the following grounds:

i) The RM1.00 payment made by the employee merely indicated the employee's acceptance of the offer. It did not give the employee the right to acquire the shares. The employees were only eligible to purchase the shares on the anniversary date in order to be the rightful owner of the shares. The employee could not maintain the offer to purchase the shares by reason of the takeover because Maxis had been delisted. There were no longer any shares to be offered. An employee who had an unvested option in ESOS had no right to acquire the shares before the anniversary date.

ii) The ECC was a cash payment in substitution of the unvested options under the ESOS. The ECC constituted a perquisite under Section 13(1)(a) of the ITA. There is no definition of the word "perquisite" under the ITA. Based on the Black's Law Dictionary, "perquisite" means "a privilege or benefit given in addition to one's salary or regular wages". This was clearly different from ESOS because for the employee to be entitled for the shares under ESOS, they must purchase the shares. The payment which was based on the "adjusted offer price less option price" was only a mechanism for making the payment but did not reflect ESOS. The payment of ECC was not an ESOS.

iii) Both Sections 25(1A) and 32(1A) of the ITA were not applicable to determine the taxability of the payment of the

ECC. By virtue of Section 25(1A) of the ITA, the perquisite is taxed in the year the employee exercised the right to purchase the shares. The mechanism to tax the perquisite is in accordance with Section 32(1A) of the ITA where the difference between the offer price and the lower of the market value of the shares on the exercisable date or the date of exercise is taxed as a perquisite.

iv) Upon a plain reading of Section 25(1A) of the ITA, the following elements must be in existence:

   a) a right to acquire shares exist;

   b) the shares must be owned by the employee/under his name;

   c) if the right to acquire the shares exist, the date when that right is exercised or released.

v) From the explanatory statements on the amendment to Sections 25 and 32 of the ITA, it clearly shows that the intention of introducing the provisions is to clarify the tax treatment on income from employment on any right to acquire shares in a company. From the explanatory statement it is also made clear that Sections 25(1A) and 32(1A) of the ITA do not apply to benefit or perquisite received by an employee by way of cash payment.

Public Rulings

Public Ruling (PR) No. 7/2014: Unit Trust Funds Part II – Taxation of Unit Trusts

PR 7/2014 was issued by the Inland Revenue Board (IRB) on 4 November 2014 to explain the taxation of unit trust funds and property trusts other than a real estate investment trust or property trust fund (REIT / PTF) regulated by the Securities Commission (SC).

This PR replaces PR 6/2013 which was published by the IRB on 23 May 2013. PR 7/2014 is issued mainly to explain the amendment in the formula for calculating permitted expenses under Section 63B of the Income Tax Act 1967 (the amendment takes effect from YA 2014). The relevant Examples 2, 3, 4 and 5 of the previous PR have also been amended accordingly. The wordings used for "**C**" (the aggregate gross income) as shown in the formula below has been changed from "*dividend (whether exempt or not), interest*" to "*dividend and interest (whether such dividend or interest is exempt or not)*".

$$A \times \frac{B}{4\mathbf{C}}$$

Where A is the total permitted expenses incurred for that basis period which consist of the following:

i) manager's remuneration;
ii) maintenance of register of unit holders;
iii) share registration expenses; and
iv) secretarial, audit and accounting fees, telephone charges, printing and stationery costs and postage.

B is the gross income consisting of dividend, interest and rent chargeable to tax for that basis period;

C is the aggregate gross income consisting of **dividend and interest (whether such dividend or interest is exempt or not)**, and rent and gains made from the realisation of investments (whether chargeable to tax or not) for that basis period.

The allowable portion of the permitted expenses calculated, subject to a minimum of 10% of the total permitted expenses incurred for the basis period, will be deducted from the aggregate income as a special deduction. If the aggregate income is insufficient or there is no aggregate income, the unabsorbed portion of the special deduction is not allowed to be carried forward to subsequent years of assessment.

PR No. 8/2014: Basis Period of a Company, Limited Liability Partnership, Trust Body and Co-operative Society

PR 8/2014 was issued by the IRB on 1 December 2014 to replace PR No. 5/2001: Basis Period for a Business Source (Co-operatives) and PR No.7/2001: Basis Period for a Business Source and Non-

Business Sources (Companies) which were both issued by the IRB on 30 April 2001.

Following the amendment to Sections 21A(3) and 21A(4) of the ITA via Finance Act 2014, PR 8/2014 was issued to explain the determination of basis period for a company, a limited liability partnership (LLP), a trust body and a co-operative society effective from year of assessment 2014 in the following situations:

i) commencement of operations; and

ii) change in accounting period for existing operations.

Paragraph 4.1 of the PR8/2014 explains how the basis period for a company, an LLP, a trust body and a co-operative society will be determined on the commencement of its operations:

If the accounts are prepared for:

i) a period of less than 12 months ending on a day in the same year, that period is the basis period for the first year of assessment;

ii) any period ending on a day in the second year, that period is the basis period for the second year of assessment and there is no basis period for the first year of assessment; and

iii) a period of more than 12 months ending on a day in the third year, that period is the basis period for the third year of assessment and there are no basis periods for the first year of assessment and the second year of assessment.

The first accounting period is the basis period for a year of assessment when the accounts are closed. It would be the first year of assessment for the entity. The above provision applies to cases where the first accounts are closed in the year 2014 and subsequent years.

Paragraph 5 of the PR8/2014 states that commencing from the year of assessment 2014, an entity which is in operations and fails to close its accounts on the same date in the following year (failure year), the DGIR will determine the basis periods for the failure year and the year following the failure year irrespective of the accounting period before the failure year. In determining the basis period for the failure year and the following year, the DGIR will accept the accounting period made up by the taxpayer in the failure year provided that:

i) there is no missing year of assessment; and

ii) there are no two or more accounts closed in the same year of assessment.

Where the new accounting period involved two years of assessment, the basis periods for the two years of assessment are determined by dividing that accounting period into two periods, any fraction of a month should be treated as falling in the first basis period when there is an uneven division of the basis periods for the two years of assessment.

Paragraph 6 of the PR8/2014 provides that where a company which is already carrying on one or more operations and commences a new operation, the basis period for the new operation is the same as the basis period of the existing operation.

News from IRB

Filing of Income Tax Return Form & CP204 for Dormant Companies

Following our report in Tax Espresso September 2014 and upon further clarifications, the IRB has informed the professional bodies that a company, a limited liability partnership, a trust body or a co-operatives society which has not commenced operation is not required to submit Form CP 204.

Application for Tax Clearance Letter for Companies under Voluntary Liquidation

Pursuant to Paragraph 2.1.1 of the IRB's Operational Guideline, GPHDN 2/2009: Tax Clearance Letter Application Procedure for Companies, an applicant company must have submitted Form C and Form R (including Form R31, if applicable) up to the current year of assessment. Where Form C and Form R for the current year of assessment have not yet been made available by the IRB, the tax return forms for the immediately preceding year of assessment may be used with some modifications by cancelling and replacing the "Year" accordingly and write the word "SPC" on top of the wordings "Year of Assessment" on the first page of the tax return forms.

Effective year of assessment 2014, all companies are required to file their tax returns electronically. Hence, companies under voluntary liquidation are also required to file the current year tax return electronically if the Form e-C for the current year of assessment is available in order to apply for a tax clearance letter.

Only if the Form e-C for the current year of assessment (e.g. year of assessment 2015 for basis period ending in 2015) is not available, the company under voluntary liquidation is allowed to use the tax return form in PDF format for the immediately preceding year of assessment which can be obtained from the nearest IRB branch. The "Year" on the first page of the tax return form in PDF format should be changed accordingly and the said completed form is required to be submitted to the IRB branch which handles the relevant company income tax file.

We invite you to explore other tax related information at:

http://www2.deloitte.com/my/en/services/tax.html

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