Deloitte Tax Challenge 2014 – Team Category Preliminary Stage

Question 1 – Income Tax and Withholding Tax (50 marks)

Alex, a network designer for Surface Networks, Inc (“Surface”), recently visited you for some Malaysian tax advisory services in respect of a transaction that his company proposes to undertake. Alex has informed that his company, Surface, is a company incorporated and tax resident in the United States of America. Surface is also principally involved in the business of providing physical servers to game publishers and content publishers around the world.

With regard to the transaction that Surface intends to undertake, Alex informs you that Surface had entered into a contract with Font, Inc (“Font”), another company located in the USA to provide game servers for their clients in Malaysia. To fulfil the contract, Surface intends to place 30 servers with a global fiber-optic network in Malaysia to serve Font’s clients in Malaysia. The servers will be placed at a leased premise at Selangor, Malaysia, and it is estimated that the operating cost of the servers placed in the premise would be RM9,000 a month. In consideration for Surface providing the servers, Font will pay Surface a sum of RM1.5 million per annum for the next six years.

Requirements

1. Based on the provisions of the Malaysian Income Tax Act 1967 (“MITA”), please advise Alex on the Malaysian income tax and withholding tax implications arising from the above proposed transaction, citing relevant sections in the MITA. (25 marks)

2. Due to a merger and acquisition in the USA, Surface now owns Font. Surface has decided for administrative ease and to serve their customers in the Asia region better, it will terminate Font’s earlier contract and enter into new agreements with the existing customers in Malaysia. The contracts will be entered into between Surface’s subsidiary, LAN Networks Pte Ltd (“LAN”), a company incorporated and tax resident in Singapore. The existing servers in Malaysia will also be re-located to Singapore to streamline server connectivity in the region.

   Surface has come out with separate two customer packages with regard to the customers in Malaysia, each explained below:-

   Pain Sdn Bhd (“Pain”)

   - Due to financial hardships, Pain has decided not to use the servers in Singapore. Instead, since LAN Networks has access to various music synthesizers, LAN Networks is able to develop their own music for integration into Pain’s own game design.

   - In the contract with Pain, Surface has made it clear that the music developed remains the property of LAN Networks and Pain will only pay for the use of the music in the games developed by Pain.

   Gain Sdn Bhd (“Gain”)

- Being a newly incorporated company, Surface foresees that the games developed by Gain will require on-site support from time to time in uploading their content into the servers maintained by LAN Networks.

- To support Gain, Alex has agreed to send the employees of LAN Networks to assist in any troubleshooting problems Gain faces from time to time. It is expected that the duration of the services will take no more than 2 days in a month.

You have been informed also by Alex that there is an existing tax treaty between Malaysia and Singapore that provides for the following withholding tax rates:-

- Royalties – 8%; and
- Technical fees – 5%.

Based on the above, Alex would like to know what are the Malaysian income tax implications arising from the above customer packages. He would like you to explain on why is there a difference on the rates used in the MITA and the Malaysia-Singapore tax treaty and which rates should be used. For now, he notes that the definition of "royalties" in the Malaysia-Singapore tax treaty is the same as per what was provided in the MITA. He also wants to know what will happen if no withholding tax has been made. (25 marks)

Question 2 - Goods and Service Tax (“GST”)

i. Briefly describe the following GST terms:-

   a. Output tax; and
   b. Input tax

   Explains how the GST payable or refundable position is derived in preparing the GST returns? (10 marks)

ii. Explain the difference between the following types of supplies (10 marks) :-

   a. Exempt supplies;
   b. Zero rated supplies; and
   c. Standard rated supplies.

iii. Malaysia will be implementing GST on 1 April 2015. In your opinion, should the country implement GST? State your view and provide reasons. (5 marks)

Question 3 –Investment Incentives

You have been approached by an investment banker who would like to provide some value added service to his clientele. He has provided you with the following scenarios:-

- Scenario 1: Mr Novo, the owner of an international marine theme park based in Australia learnt that Legoland has been highly successful in attracting many local and foreign tourists. He is exploring the idea of introducing a whale and dolphin sanctuary in Iskandar Johor. What are the possible fiscal and non fiscal incentives he may seek from the government? Geographically, What are the strategic advantages Iskandar Johor has? (10 marks)

- Scenario 2: ABC Ltd, a China based company, is sourcing for a suitable aquaculture site for the breeding of the barramundi (siakap) fish. Based on marine survey done, ABC Ltd found that the climate and water in Malaysia is a suitable breeding ground. They are considering Lahad Datu and Endau-Rompin. What are the tax incentives available for aquaculture and would operating in Lahad Datu be given better incentive? Apart from tax incentives, what are the other major non tax factors the investors must consider in deciding the site location? (10 marks)

- Scenario 3: Sun Solar Ltd from UAE, has developed a fully integrated building solar panel technology capable of generating electricity. They will sell the technology to any Malaysian companies that are keen to build the facilities to generate and use the power for their own office buildings. They want to know what kind of tax incentives the buyers of their technology can enjoy (5 marks).