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Transitional provisions – new tax administration law

As part of the transitional provisions, GR 80/2007 sets out eight cases under which the 2007 KUP should prevail (Please refer to TaxFlash No.02/2008). Questions have been raised regarding the government's rationale for designating those cases and the thread connecting the designated cases with the transitional provisions stated in the KUP law.

This question was answered in part by a senior officer of the DGT in a recent informal discussion with us. As explained by the officer, the DGT essentially distinguished taxpayers' rights and obligations on the one hand from tax administration and tax service issues on the other hand. Taxpayers' rights and obligations for a particular tax year should be settled in accordance with the KUP law prevailing during that particular year. However, with a view to giving better services to taxpayers, effective from 2008 the DGT committed to use the 2007 KUP for tax administration issues for any tax years. The eight cases designated in GR 80 reflected this commitment.

We noted that it would not always be easy in practice to make a clear-cut distinction between rights/obligations and tax administration issues. However, we raised several frequently asked questions (FAQs) during this discussion to get a clearer understanding how the DGT would approach certain practical cases. A summary of the FAQs is presented at the back of this TaxFlash. Please note, however, that in practice the DGT's approach

may be different from that explained by the tax officer and set out in the summary. If you are in doubt over any issue please contact your PwC tax advisor.

Tax-neutral mergers

The MoF has just issued Reg. 43/PMK.03/2008 (Reg. 43) regarding tax-neutral mergers and expansions. The regulation is effective from 13 March 2008 and is meant to replace Reg. 422/KMK.04/1998 as amended by Reg. 75/PMK.03/2005, which has reportedly been suspended since 2007 (Refer to TaxFlash No. 6/2007).

The tax-neutral feature of the mergers or expansions refers to the asset transfers between the parties involved which are accounted for at tax book value. In the absence of any special rules, such transfers must be carried out

at market value. Reg. 43 allows tax neutral mergers or expansions based on specific DGT approval. Hence, companies wishing to use this facility need to submit approval requests to the DGT.

The most notable feature of Reg. 43 is the requirement for the merger or expansion plans to pass a business purpose test. This is a type of commercial justification for the plans. Tax-driven arrangements are prohibited. When several companies merge, for instance, the surviving company should be the one which does not have any tax losses or has the least tax losses. Losses from one company may not be transferred to the surviving company. At this stage how the business test will be undertaken is still unclear. This should be elaborated on a DGT regulation, which has yet to be issued.

The other feature is that there is no longer a requirement to liquidate the merging companies. This puts the new regulation in line with the 2007 company law.

FAQs regarding transitional provisions

Case	Issues	Remarks on the applicable KUP
1.	<p>A tax audit for 2005 commenced in 2007 and continued into 2008.</p> <p>Which KUP is applicable for the tax audit?</p>	<p>2000 KUP</p> <p>Given that the audit commenced¹ before 31 December 2007, the 2000 KUP should prevail irrespective of when the audit is completed. This is confirmed by MoF 199/PMK.03/2007, dealing with tax audits. Arguably, the one-month rule should not be applicable for the rest of the audit taking place in 2008. However taxpayers are advised to ensure documentation is in order to avoid any challenge by a tax auditor that documents must be provided within one month.</p>
2.	<p>We received early this week a tax audit instruction letter dated 14 March 2008 for an audit of the 2006 tax year.</p> <p>Which KUP is applicable for the tax audit?</p>	<p>2000 KUP and 2007 KUP</p> <p>The taxpayer's rights and obligations should only be dealt with in accordance with the 2000 KUP. Hence, the audit adjustments agreed in the closing conference should not transform into a minimum payment requirement once the assessment is issued. However, the one-month rule and the tax audit notice and closing conference requirements, being regarded as administrative or a tax service issue, are applicable.</p>
3.	<p>Suppose a tax audit for 2008 commences early in 2009.</p> <p>Will the 2007 KUP govern the tax audit?</p>	<p>2007 KUP</p> <p>The 2007 KUP along with MoF 199 would be fully applicable. Consequently, the tax audit adjustments agreed during the closing conference would be</p>

Case	Issues	Remarks on the applicable KUP
		transformed into a minimum payment requirement. The one-month rule and the tax audit notice and closing conference requirements would also be applicable.
4.	<p>In Case 1 above, suppose the closing conference was held in January 2008, and a tax underpayment assessment letter was issued in February with the due date falling in March. The taxpayer then proceeds to file an objection and paying only the amount agreed during the closing conference.</p> <p>What is the DGT's likely approach relating to the unpaid portion of the tax assessment?</p>	<p>2000 KUP</p> <p>The minimum payment requirement is not applicable given that the assessment pertains to the 2005 tax year. Based on the 2000 KUP, the taxpayer has to pay the whole amount of the tax assessments. The DGT may undertake forced tax collection efforts using a distress warrant in respect of the unpaid portion of the tax assessment. The same approach could also be used for Case 2 if there is a portion of the tax assessment unpaid.</p>
5.	<p>Tax objections are filed in respect of tax assessment letters issued following tax audits in Cases 1 and 2.</p> <p>Will payment or non-payment of the assessments affect the validity of the objections?</p>	<p>2000 KUP</p> <p>Given that the tax assessments belong to pre-2008 years, payment or non-payment of the assessments will not affect to the validity of the objections. However, as set out in the fourth example, the DGT may undertake forced tax collection efforts using a distress warrant in respect of the unpaid portion of the tax assessments.</p>
6.	<p>Suppose the tax objections in Case 5 are filed some time in 2008.</p> <p>How will the DGT process the objections?</p>	<p>2000 KUP and 2007 KUP</p> <p>As stipulated in GR 80/2007, tax objections filed after 31 December 2007 will be processed in accordance with the 2007 KUP. However, non-payments of the underpaid tax assessments, which belong to pre-2008 years, in accordance with the 2000 KUP, should not render the objections invalid. Nevertheless, the DGT may undertake forced tax collection efforts using a distress warrant in respect of the unpaid portion of the tax assessments.</p>
7.	<p>Referring to Cases 1, 4 and 5 (tax audit for 2005 started in 2007, tax assessments were issued and tax objections were filed in 2008), suppose that the taxpayer failed to deliver certain documents to the tax auditors during the audits.</p> <p>Assuming the taxpayers can only deliver the documents in the objection process, can the DGT ignore those documents?</p>	<p>2000 KUP</p> <p>The one month rule arguably should not be applicable for tax objections pertaining to pre-2008 years with a tax audit commencing before 31 December 2007.</p>

Case	Issues	Remarks on the applicable KUP
8.	<p>Referring to Cases 2 and 5 (tax audit for 2006 started in 2008, tax assessments were issued and tax objections were filed in 2008), suppose that the taxpayer failed to deliver certain documents to the tax auditors during the audits.</p> <p>Assuming the taxpayers can only deliver the documents in the objection process, can the DGT ignore those documents?</p>	<p>2007 KUP</p> <p>The DGT is more likely to consider documents' delivery during a tax audit as an administration issue. Consequently, given that the audit commenced in 2008, the DGT might ignore the documents not delivered during the tax audit but only presented in the tax objection process.</p>
9.	<p>Suppose that the objections pertaining to the 2005 and 2006 tax years (Cases 1, 2, and 5) are decided in the taxpayers' favour, resulting in an amount being payable by the DGT to the taxpayer.</p> <p>Which KUP should govern the calculation of the interest compensation?</p>	<p>2000 KUP</p> <p>Interest compensation is the taxpayer's right. As it pertains to pre-2008 years, the interest compensation should be calculated in accordance with the 2000 KUP.</p>
10.	<p>Under the 2000 KUP, a revision of the tax return for a particular year can only be made within two years of the end that year before the commencement of a tax audit. There is no time limit under the 2007 KUP except for tax returns containing tax losses and/or overpaid tax.</p> <p>Can we now ignore the two-year time limit for the revision of pre-2008 tax returns?</p>	<p>2007 KUP</p> <p>There is no tax regulation confirming that the two-year time limit is no longer applicable starting in 2008 for any tax years. However, in an informal discussion with us, a senior officer of the DGT stated that revisions of pre-2008 tax returns can be made without regard to the two-year time limit.</p>

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