

# TAX BULLETIN

KDN PP 10572/9/2006

*2007 Budget  
Highlights*

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## FOREWORD

The 2007 budget which was announced on 1 September 2006 is an action plan to spearhead the implementation of the “National Mission” towards realising “Vision 2020”, in making Malaysia a developed nation. The “National Mission” enunciated under the 9th Malaysian Plan, outlines the five key development policy thrusts as follows:-

- (1) To move the economy up the value chain;
- (2) To raise the capacity for knowledge and innovation and nurture “first class mentality”
- (3) To address persistent socio-economic inequalities constructively and productively;
- (4) To improve the standard and sustainability of quality of life; and
- (5) To strengthen the institutional and implementation capacity.

Various strategies and programmes have been formulated in the 2007 Budget in implementing the “National Mission” through budget allocations and legislative tax changes and tax incentives. This bulletin outlines only the various tax incentives and changes to tax legislation as proposed in the 2007 Budget.

At the corporate front, several tax incentives have been introduced or enhanced and in particular, to promote growth and development in the areas of Biotechnology, Islamic banking and financing, financial services, venture capital and Real Estate Investment Trusts.

The reduction in the corporate income tax rates from 28% to 26% over a two year period is a welcome sign as the last reduction of corporate tax was made in the year 1998.

In terms of tax on individuals, the proposals made in this budget are aimed at raising the capacity for knowledge and enhancing human skills by improving the current tax relief and incentives in respect of purchase of computers, books and relief for further education.

In the area of tax administration, the budget has introduced various mechanisms to provide a tax efficient system in the country as well as to bring about greater compliance by providing better understanding of the Inland Revenue Board’s (IRB) practices. The proposals include the establishment of customs tribunal, implementation of advance tax rulings by the IRB and the Royal Malaysian Customs (RMC), and issuance of guidelines on audit and investigation by the IRB.

Amendments are made to tax laws to tighten up certain provisions to minimise ambiguities and differences in opinion. These amendments include the adoption of the special tax treatment for property development and construction businesses which are currently prescribed under the Public Ruling 3/2006 in the tax law and the deemed disposal on the transfer of fixed assets to trading stock under the Real Property Gains Tax Act, 1976. These proposals may be viewed unfavourably by some but on a positive note, these will definitely present a clearer tax position for the application by tax payers.

### IMPORTANT NOTE

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## 1. TAX SYSTEM AND ADMINISTRATION

### 1.1 FRAMEWORK FOR TAX AUDIT AND INVESTIGATION BY INLAND REVENUE BOARD

#### **Present**

Tax audit is the primary activity of the Inland Revenue Board (IRB) to enhance voluntary compliance under the self assessment system, whilst tax investigation is an enforcement activity carried out to curb tax evasion.

Currently, information on tax audit can be obtained from the “IRB Guide on Tax Audit” but no guideline on investigation has so far been issued by IRB.

#### **Proposed**

The existing Guide on tax audit be updated and the framework for tax investigation be issued by the IRB.

The main areas to be covered in the guideline/framework are as follows: -

- (i) criteria for audit and investigation selection;
- (ii) tax audit and investigation methodology;
- (iii) rights and responsibilities of taxpayers and tax agents, audit and investigation officers;
- (iv) settlement upon completion of an audit or investigation; and
- (v) offences and penalties.

#### **Effective**

1 January 2007.

### 1.2 INTRODUCTION OF ADVANCE RULINGS IN INCOME TAX ADMINISTRATION

#### **Present**

There is no specific provision for the issuance of advance ruling in the Income Tax Act 1967. The Inland Revenue Board (IRB) issues Public Rulings to make known the Director General’s interpretation of provisions of the Act that have general applications. If a taxpayer does not agree with the interpretation, he may request for a private ruling.

#### **Proposed**

It is proposed that specific provisions be introduced under the Income Tax Act 1967, to allow a taxpayer to request for an advance ruling.

An advance ruling is a written statement given by the Director General on the tax treatment of an arrangement to be undertaken by the taxpayer.

The salient features of the advance ruling system to be introduced are as follows: -

- (i) application to be made in a prescribed form;
- (ii) fees to be charged on the application for advance ruling;
- (iii) the ruling is only applicable to the applicant;

- (iv) the ruling can only be issued based on actual facts and not based on assumptions; and
- (v) the advance ruling issued by IRB is not applicable if the facts used in making the advance ruling are incorrect or different.

**Effective**

1 January 2007.

**1.3 INTRODUCTION OF  
CUSTOMS RULING**

**Present**

There is no clear legal framework for obtaining rulings from the Royal Malaysian Customs (KDRM). Any person can apply to the KDRM in respect of the classification or valuation of goods or services in order to determine the class and duty of such goods or the tax treatment of such services.

**Proposed**

Customs Rulings be introduced under the Customs Act 1967, Sales Tax Act 1972, Service Tax Act 1975 and Excise Act 1976.

The Rulings issued by the KDRM and agreed by the relevant applicants shall be legally binding between both parties for a specific period of time.

The main features of Customs Rulings to be introduced are as follows: -

- (i) application for Customs Ruling can be made with respect to classification of goods, determination of taxable services and the principles for determination of value of goods and services;
- (ii) application to be made in writing together with sufficient facts and a prescribed fee;
- (iii) application may be made before the goods are imported or the services are provided upon which KDRM will issue an advance ruling;
- (iv) the Customs Ruling is only applicable to the applicant; and
- (v) the Director General of Customs may amend, modify or revoke a Ruling if there is any error in the Ruling due to typing or the wrong reference or if the Ruling is based on an error of fact as in the case of the use of incomplete analysis done on a product or if there is a change in law which can result in a new tariff structure.

**Effective**

1 January 2007.

#### **1.4 ESTABLISHMENT OF CUSTOMS APPEAL TRIBUNAL**

##### **Present**

Disputes pertaining to technical and administrative decisions by the Royal Malaysian Customs (mostly related to classification and valuation of goods and taxable services) may be appealed to the Minister of Finance.

##### **Proposed**

An independent body known as the Customs Appeal Tribunal (CAT) be established to decide on appeals against the decisions of the Director General of Customs pertaining to matters under the Customs Act 1967, Sales Tax Act 1972, Service Tax Act 1975 and Excise Act 1976. The main features of CAT are as follows:

- (i) the Tribunal shall consist of not less than three (3) members of which the Chairman shall be from the judicial and legal service and other members with experience in taxation or custom matters;
- (ii) appeal against the decision of the Director General of Customs shall be made within 30 days from the date of notification of that decision; and
- (iii) the decision of the Tribunal shall be final except on such cases where there shall be further right of appeal to the High Court or Federal Court.

##### **Effective**

1 March 2007.

## **2. TAXATION - PERSONS OTHER THAN COMPANIES**

#### **2.1 TAX TREATMENT ON PERQUISITES**

##### **Present**

Perquisites or benefits in cash or in kind such as long service award and excellent service award received by an employee are considered as income and subject to tax.

##### **Proposed**

Tax exemption of up to RM1,000 per annum be given to an employee receiving such perquisites or benefits.

For the purposes of this exemption, service award: -

- (i) cannot be a disguised wage;
- (ii) must be awarded as part of a meaningful contribution to the organization; and
- (iii) is not provided frequently to the same employee.

For long service award, it is given to employees who have served at least 10 years with the same employer.

##### **Effective**

Year of Assessment 2007.

**2.2 INCOME TAX  
EXEMPTION FOR  
SEAFARERS  
WORKING ON  
BOARD A FOREIGN  
SHIP**

**Present**

Income of a seafarer who works on board a “Malaysian ship” is exempted from tax.

In this context, a “Malaysian ship” means a seagoing ship registered under the Merchant Shipping Ordinance 1952, other than a ferry, barge, tug-boat, supply vessel, crew boat, lighter, dredger, fishing boat or other similar vessel.

Income of a seafarer employed by a Malaysian shipping company on board a “foreign ship” is not given tax exemption.

**Proposed**

The income of a seafarer derived from exercising an employment on board a foreign ship used in a business operated by a Malaysian resident person (being a registered owner of a ship under the Merchant Shipping Ordinance 1952) be given tax exemption.

**Effective**

Year of Assessment 2007.

**2.3 EXTENDING THE  
SCOPE OF  
COMPENSATION  
FOR LOSS OF  
EMPLOYMENT**

**Present**

No exemption is given on payments received by an employee pursuant to a separation scheme where employees are given an option for early termination of an employment contract. The exemption of RM6,000 per completed year of service is only given on compensation for loss of employment received by a person.

**Proposed**

It is proposed that the compensation for loss of employment to include any payment received by an employee from his employer pursuant to a “separation scheme”. The tax exemption would not apply if the “separation scheme” provides for re-employment by the same or any other employer.

**Effective**

Year of assessment 2007.

**2.4 REVIEW OF TAX  
RELIEF FOR  
PURCHASE OF  
BOOKS**

**Present**

Individual taxpayer is eligible for tax relief of up to RM700 per year on the purchase of books.

**Proposed**

The tax relief be increased to RM1,000 per year.

**Effective**

Year of Assessment 2007.

**2.5 ENHANCING TAX  
TREATMENT ON  
LOCAL LEAVE  
PASSAGE**

**Present**

Income tax exemption is given to employees in respect of the following benefit provided by the employer in any calendar year:-

- (a) Leave passage for travel within Malaysia not exceeding 3 times; or
- (b) One leave passage for overseas travel (limited to RM3,000).

The exemption does not cover meals and accommodation provided by the employer.

**Proposed**

Tax exemption on benefit provided by employer for local leave passage be extended to include expenses on meals and accommodation.

**Effective**

Year of Assessment 2007.

**2.6 REVIEW OF TAX  
INCENTIVE FOR  
THE PURCHASE OF  
COMPUTER**

**Present**

Individual taxpayers are eligible for a tax rebate of RM500 for the purchase of a computer once in every 5 years per household.

**Proposed**

The tax rebate be replaced with tax relief of up to RM3,000, claimable once in every 3 years.

In the case where a taxpayer and his spouse opt for separate assessment, both the taxpayer and his spouse are eligible to claim the relief. In the case of combined assessment, the amount shall be deemed to have been incurred by the spouse who pays income tax.

**Effective**

Year of Assessment 2007.

**2.7 EXTENDING THE  
SCOPE OF  
INDIVIDUAL TAX  
INCENTIVE FOR  
FURTHER  
EDUCATION**

**Present**

Tax relief not exceeding RM5,000 per annum is given to individuals for fees incurred for pursuing courses at local institutions of higher education in the fields of science, technical, vocational, industrial skills development, information and communication technology, accountancy and law.

**Proposed**

The scope of courses be extended to include Islamic financing courses approved by Bank Negara Malaysia or Securities Commission conducted at local institutions of higher education including at the International Centre for Education in Islamic Finance (INCEIF).

**Effective**

Year of Assessment 2007.

### 3. TAXATION - COMPANIES & UNINCORPORATED BUSINESSES

#### 3.1 REDUCTION OF CORPORATE INCOME TAX RATE

##### **Present**

The corporate income tax rate is at 28%. This rate also applies to the following entities: -

- (i) a trust body;
- (ii) an executor of an estate of an individual who was domiciled outside Malaysia at the time of his death; and
- (iii) a receiver appointed by the court.

Small and medium scale companies (SMEs) with paid up capital not exceeding RM2.5 million are taxed at 20% on chargeable income up to RM500,000 and the remaining amount at 28%.

##### **Proposed**

The income tax rate for companies (including SMEs) be reduced by two percentage points in two stages. For the year of assessment 2007, the rate will be reduced from 28% to 27%.

For the year of assessment 2008, the rate will be further reduced to 26%. The new rates also apply to the following entities :-

- (i) a trust body;
- (ii) an executor of an estate of an individual who was domiciled outside Malaysia at the time of his death; and
- (iii) a receiver appointed by the court.

##### **Effective**

Year of assessment 2007.

#### 3.2 REVIEW OF PENALTY ON WITHHOLDING TAX

##### **Present**

Payments made to non-residents such as contract payments, interest, royalty, rental of moveable property and technical fees, are subject to withholding tax. A 10% penalty on the gross payment made to non-residents will be imposed for withholding tax not paid.

A Real Estate Investment Trust (REIT) or Property Trust Fund (PTF) which fails to pay the withholding tax from the distribution of income to non-resident unit holder will also be subject to a penalty equivalent to 10% of the amount distributed.

##### **Proposed**

The 10% penalty on withholding tax be imposed on the unpaid withholding tax and not on the gross payment made to non-residents or income distributed to the non-resident unit holders by REIT or PTF.

##### **Effective**

2 September 2006.

**3.3 SPECIAL TAX  
TREATMENT FOR  
THE PROPERTY  
DEVELOPMENT  
AND  
CONSTRUCTION  
CONTRACT  
BUSINESSES**

**Present**

The gross income and adjusted income from property development and construction contract (PDCC) businesses are ascertained using the percentage of completion method as prescribed in the Director General's "Public Ruling No. 3/2006: Property Development and Construction Contracts".

**Proposed**

Special regulations to be formulated and published in the *Gazette* with the purpose of bringing the PDCC businesses within the ambit of Section 36(a)(iv) of the Income Tax Act, 1967.

The salient features of the regulations are as follows: -

(i) Recognition of income

The gross income from the PDCC businesses for a basis period for the year of assessment shall be determined by using the percentage of completion method;

(ii) Date of commencement of business

The specific date to be determined as the date of commencement of the PDCC businesses is based on specific circumstances and facts acceptable to the Director General;

(iii) Date of completion of a project or contract

A development project shall be deemed to be completed upon the date of issuance of the Temporary Certificate of Fitness for Occupation, or Certificate of Fitness for Occupation, whichever is earlier;

A construction project shall be deemed to be completed upon the date on which the Certificate of Practical Completion is issued or where no such Certificate is issued, the date upon which the contract work is substantially completed, whichever is earlier ;

(iv) Revision of estimates

Revision of the estimates of gross profit from the PDCC can be allowed where there is an increase in development or construction costs due to escalating cost of materials, a reduction in selling price or contract sum or other commercial reasons acceptable to the Director General;

**3.3 SPECIAL TAX  
TREATMENT FOR  
THE PROPERTY  
DEVELOPMENT  
AND  
CONSTRUCTION  
CONTRACT  
BUSINESSES  
(Cont'd)**

(v) Deductibility of expenses incurred during the defect liability or warranty (DLW) period

Expenses incurred during the DLW period shall be allowed for deduction against the income of the year of assessment in which the expenses are incurred, or shall be carried forward to the following years of assessment for future set off.

However, the property developer or the construction contractor may elect to carry back the expenses to the basis period for the year of assessment in which the project/contract is completed.

Where the income in the year of completion of the project/contract is insufficient to set off the expenses incurred, the excess of the expenses is allowed to be carried back further to be deducted from the income for the immediately preceding years of assessment for the duration of the project/contract.

The option to elect is available to the property developer or construction contractor for each year of assessment for the duration of the DLW period;

(vi) Final accounts

On submission of the final accounts upon the completion of the project/contract :-

1. any income from the project/contract which has not previously been included in the gross income shall be included in the gross income for the basis period for the year of assessment in which the project/contract is completed;
2. any losses ascertained may be apportioned to each year of assessment for the duration of the project/contract by using the percentage of completion method; and
3. where the actual gross profit is less than the total estimated gross profit, the property developer or the construction contractor may review the assessment for the immediate preceding year of assessment prior to the year of completion of the project/contract. However, the property developer or construction contractor may elect to review all the relevant assessments by apportioning the actual gross profit to each year of assessment over the duration of the project/contract using the percentage of completion method.

**Effective**

Year of assessment 2006.

**3.4 TAX TREATMENT  
ON PAYMENT FOR  
RENTAL OF SHIP**

**Present**

Rental payments made by Malaysian resident shipping companies engaged in the business of transporting passenger or cargo to a non-resident under an agreement for participation in a pool is exempted from income tax.

**Proposed**

Payments made by a Malaysian resident company to a non-resident for the rental of ships under voyage charter, time charter or bare boat charter be exempted from income tax.

**Effective**

2 September 2006.

**3.5 TAX TREATMENT  
OF DEBT  
RELEASED**

**Present**

The release of debt in respect of any outgoing or expenses that was previously allowed for deduction under section 33(1) of the ITA shall be treated as gross income of the relevant person for the relevant period. However, there is no legislation provided for circumstances where capital allowances were claimed in respect of any expenditure incurred that is subsequently released.

**Proposed**

Where capital allowance under Schedule 3 of the ITA have been made on expenditure in computing the statutory income of a business for a year of assessment, the whole or any part of the debts in respect of such expenditure so released shall be treated as gross income from the business.

**Effective**

Year of assessment 2007.

**3.6 ENHANCING  
INCENTIVE FOR  
SPONSORING ARTS  
AND CULTURAL  
PERFORMANCES**

**Present**

Companies that sponsor local and foreign arts and cultural performances approved by the Ministry of Culture, Arts and Heritage are allowed a deduction of up to RM300,000 per year. However, the deduction allowed for foreign performances should not exceed RM200,000 of the total annual deduction allowed.

**Proposed**

Deduction on expenditure incurred in sponsoring local arts, cultural and heritage performances and shows be increased to RM500,000 per year whilst the ceiling for deductions allowed on foreign performances and shows remains at RM200,000 per year.

**Effective**

Year of assessment 2007.

**3.7 INCREASING THE  
LIMIT AND  
WIDENING THE  
SCOPE OF  
DEDUCTION ON  
DONATION FOR  
CHARITABLE  
ACTIVITIES**

**Present**

Companies that contribute cash donations to an approved institution, organization or fund for charitable purposes are eligible for deduction up to 5% of their aggregate income. However, such deduction is not extended for similar contributions made by companies towards sport activities.

**Proposed**

- (i) Current limit on deduction given to companies on contributions for charitable activities be increased from 5% to 7% of their aggregate income.
- (ii) The deduction as stipulated in item (i) be extended to gift of money or contributions in kind made by companies towards sport activities approved by the Minister of Finance (MOF) or sport bodies approved by the Commissioner of Sports or any project of national interest approved by the MOF;

The deduction shall be subject to condition that the sum of the above contributions [items (i) and (ii)] does not exceed 7% of the companies' aggregate income.

**Effective**

Year of assessment 2007.

**3.8 REMOVAL OF TAX  
REBATE – LOAN TO  
SMALL BUSINESS**

**Present**

A tax rebate of 2% or any other rate prescribed by the Ministry of Finance on the outstanding amount of loan is allowed against the income tax chargeable on a person who gives loan to a small business.

**Proposed**

The tax rebate provision to be deleted as the loan to small business is no longer relevant.

**Effective**

Year of assessment 2007.

**3.9 TAX TREATMENT  
ON ZAKAT PAID BY  
COOPERATIVES  
AND TRUST BODIES**

**Present**

*Zakat perniagaan* paid by companies is allowed as deduction, subject to a maximum of 2.5% of the aggregate income of a company. Such deduction was not extended to co-operative societies and trust bodies.

**Proposed**

Deduction be extended to co-operative societies and trust bodies.

**Effective**

Year of Assessment 2007.

**3.10 DEDUCTION FOR  
LEAVE PASSAGE  
TO EMPLOYEES**

**Present**

Leave passage provided by an employer to an employee is not allowable for tax deduction under section 39(1)(m) of the ITA.

**Proposed**

The provision of a benefit or amenity consisting of a leave passage to facilitate a yearly event within Malaysia which involves the employer, the employee and the immediate family members of that employee, be allowed as a deduction.

**Effective**

Year of assessment 2007.

**3.11 GROUP RELIEF –  
APPEAL FOR  
PENALTY FOR  
INCORRECT LOSS  
SURRENDERED**

**Present**

Group relief provision was introduced from the year of assessment 2006. Where the surrendering company gives incorrect information in the tax return furnished in respect of the amount of the adjusted loss surrendered, the Director General may require the company to pay a penalty equal to the amount of tax which had or would have been undercharged by the claimant company.

**Proposed**

Where the surrendering company is dissatisfied with the penalty, the surrendering company may appeal to the Special Commissioner against the penalty imposed.

**Effective**

Year of assessment 2007.

**3.12 INVESTMENT  
HOLDING  
COMPANY -  
REDEFINED**

**Present**

An “investment holding company” is defined as a company whose activities consist mainly of the holding of investments and not less than 80% of its gross income is derived from holding of investments.

**Proposed**

An “investment holding company” be redefined as a company whose activities consist mainly of the holding of investments and not less than 80% of its gross income other than gross income from a source consisting of a business of holding of an investment (whether exempt or not), is derived from holding of investments.

The “business of holding of investment” is defined as the business of letting of property where a company in any year of assessment provides any maintenance or support services in respect of the property.

**Effective**

Year of assessment 2006.

**3.13 AMENDMENT OF SECTION 37F AND 42B OF SCHEDULE 3 – INDUSTRIAL BUILDING ALLOWANCE**

**Present**

A building used by a person solely for the purpose of a hotel registered with the Ministry of Cultural, Arts and Tourism is regarded as an industrial building and qualifies for industrial building allowance (IBA).

Capital expenditure incurred by a person on the construction or purchase of a building for a school or an education institution approved by the Minister of Education or any other relevant authorities is regarded as an industrial building which qualifies for IBA.

**Proposed**

Building used by a person solely for the purpose of a hotel to be registered with the **Ministry of Tourism** instead of Ministry of Cultural, Arts and Tourism in order to qualify for IBA.

Capital expenditure incurred by a person on the construction or purchase of a building for a school or an education institution be approved by the Minister of Education **or Minister of Higher Education** or any other relevant authorities in order to qualify for IBA.

**Effective**

Year of assessment 2007.

**3.14 REVIEW OF TAX TREATMENT ON BILATERAL CREDIT**

**Present**

Bilateral credit in respect of foreign income to be allowed to a person is restricted to the lower of the foreign tax suffered or so much of the Malaysian tax payable by him for that year as bears to the whole of that Malaysian tax the same proportion as that foreign income bears to his total income for the year as follows :-

$$\frac{\text{Foreign income}}{\text{Total income}} \times \text{Malaysian tax payable}$$

Note :

For this purpose, “foreign income” is defined as “income derived from outside Malaysia”.

**Proposed**

(i) The ascertainment of bilateral credit in respect of foreign income shall be amended and referred to the statutory income in respect of the foreign income as follows :-

$$\frac{\text{Statutory income in respect of Foreign income (see item (ii))}}{\text{Total income}} \times \text{Malaysian tax payable}$$

(ii) Foreign income is expanded to include income derived from Malaysia charged to foreign tax.

**Effective**

Year of assessment 2007.

## 4. TAX INCENTIVES

### 4.1 REVIEW OF INCENTIVES FOR BIOTECHNOLOGY INDUSTRY

#### Present

Companies involved in the biotechnology industry are eligible for the following tax incentives:

- (1) A company undertaking biotechnology activity and has been approved with bionexus status by the Malaysian Biotechnology Corporation Sdn Bhd is eligible for the following incentives:-
  - (i) 100% income tax exemption for 10 years commencing from the date of commencement of commercial production OR Investment Tax Allowance of 100% on the qualifying capital expenditure incurred within a period of 5 years;
  - (ii) tax exemption on dividends distributed by a bionexus company;
  - (iii) exemption of import duty and sales tax on raw materials / components and machinery / equipment;
  - (iv) double deduction on expenditure incurred for R&D; and
  - (v) double deduction on expenditure incurred for the promotion of exports;

AND

2. A company that invests in its subsidiary, which is a bionexus status company, is granted tax deduction equivalent to the amount of investment made in that subsidiary provided that the investing company owns at least 70% of that subsidiary.

#### Proposed

1. The existing incentive in Para 1 (i) be enhanced by amending the commencement date of the exemption period from the date of commercial production to the first year the company derives profit;
2. New incentives be introduced as follows: -
  - (i) a bionexus company be given a concessionary tax rate of 20% on income from qualifying activities for 10 years upon the expiry of the tax exemption period;
  - (ii) a company or an individual investing in a bionexus company be given a tax deduction equivalent to total investment made in seed capital and early stage financing;
  - (iii) a bionexus company undertaking merger and acquisition with a biotechnology company be given exemption of stamp duty and real property gains tax within a period of 5 years until 31 December 2011; and
  - (iv) buildings used solely for the purpose of biotechnology research activities be given Industrial Building Allowance over a period of 10 years.

Applications for these incentives will be evaluated by a Committee under the Malaysian Biotechnology Corporation Sdn Bhd and recommended for approval by the Minister of Finance.

**Effective**

2 September 2006

**4.2 REVIEW OF  
INCENTIVE FOR  
REAL ESTATE  
INVESTMENT  
TRUSTS (REITs)**

**Present**

Tax incentives available to Real Estate Investment Trusts (REITs) are as follows :-

- (i) Real Property Gains Tax (RPGT) exemption on gains from disposal of real property by individuals or companies to REITs;
- (ii) Stamp duty exemption on instruments of transfer of real property from individuals or companies to REITs;
- (iii) Income tax exemption on total income of REITs distributed to unit holders;
- (iv) Income distributed to unit holders is taxed at their respective tax rates. For non-resident unit holders, tax payable is at 28% and is withheld by REITs through the withholding tax mechanism;
- (v) Tax credit is given to unit holders on the accumulated income of REITs which was subjected to tax and subsequently distributed to unit holders; and
- (vi) Fees for consultancy, legal and valuation services incurred in the establishment of REITs are allowed for tax deduction.

**Proposed**

It is proposed that:-

- (i) Non-corporate investors (especially resident and non-resident individuals) and other local entities that receive dividends from REITs listed on the Bursa Malaysia be subject to a final withholding tax of 15% for 5 years;
- (ii) Foreign institutional investors (especially a pension fund, collective investment scheme) that receive dividends from REITs listed on Bursa Malaysia be subject to a final withholding tax of 20% for 5 years;
- (iii) Local and foreign corporate investors be subject to existing tax treatment and tax rates;
- (iv) REITs be exempted from tax on all income provided that at least 90% of their total income is distributed to the investors; and
- (v) If the 90% distribution condition is not complied with, REITs will then be subject to income tax, while all their investors are eligible to claim tax credit.

**Effective**

Proposals (i) and (ii) : effective from 1 January 2007;

Proposals (iv) and (v) : effective from year of assessment 2007

#### **4.3 EXTENSION OF INCENTIVE PERIOD FOR TOUR OPERATORS**

##### **Present**

The following incentives are given to tour operators: -

- (i) tax exemption on statutory income derived from the business of operating domestic tour packages participated by at least 500 inbound tourists per year; and / or
- (ii) tax exemption on statutory income derived from the business of operating domestic tour packages participated by at least 1,200 local tourists per year.

These incentives are effective until year of assessment 2006

##### **Proposed**

The above income tax exemption for tour operators be extended for another 5 years from the year of assessment 2007 to 2011.

##### **Effective**

Year of assessment 2007 to 2011.

#### **4.4 EXTENDING THE PROMOTED AREAS**

##### **Present**

Promoted areas are the Eastern Corridor of Peninsular Malaysia, which includes Kelantan, Terengganu, Pahang and district of Mersing in Johor, Sabah and Sarawak.

The following incentives are given to companies located in promoted areas: -

- (i) Pioneer Status with tax exemption of 100% of statutory income for a period of 5 years; or
- (ii) Investment Tax Allowance of 100% on qualifying capital expenditure incurred within 5 years, and which can be set-off against 100% of statutory income for each year of assessment with the condition that the companies undertake promoted activities or produce promoted products;
- (iii) Infrastructure Allowance of 100% of qualifying capital expenditure incurred on infrastructure such as bridges, roads and ports. The allowance can be set-off against 100% of statutory income for each year of assessment; and
- (iv) Reinvestment Allowance of 60% of qualifying capital expenditure is given to manufacturing and selected agriculture projects. The allowance can be set-off against 100% of statutory income for each year of assessment.

##### **Proposed**

Perlis is to be declared as a promoted area. Companies located in that state and undertaking promoted activities or promoted products will be eligible for enhanced incentives currently given to other existing promoted areas.

##### **Effective**

For application received by the Malaysian Industrial Development Authority (MIDA) from 2 September 2006.

**4.5 EXTENSION OF THE SCOPE OF INCENTIVE FOR THE CAPITAL MARKET GRADUATE TRAINING SCHEME**

**Present**

Claim for double deduction is given to companies listed on the Bursa Malaysia on allowances paid to participants in the Securities Commission (SC) Capital Market Graduate Training Scheme, commencing from 1 October 2005 until 31 December 2008.

Such deduction is given for a period of 3 years from the commencement date of the scheme.

**Proposed**

The above claim for double deduction will be extended to non-listed companies under the supervision of the SC.

In addition, the claim of double deduction incentive will also be extended to companies, both listed and unlisted for the conduct of in-house training schemes for graduates, which have been certified by the SC.

These incentives will commence from 2 September 2006 until 31 December 2008 and double deduction will be given for a period of 3 years from the date of commencement of scheme.

**Effective**

2 September 2006.

**4.6 ENHANCING THE INCENTIVE FOR PROMOTION OF MALAYSIAN BRAND NAME**

**Present**

Advertising expenditure incurred by companies in the promotion of Malaysian brand name locally is eligible for the claim of double deduction, subject to the following criteria: -

- (i) the company is incorporated in Malaysia and at least 70% of its equity is owned by Malaysians;
- (ii) the company is the registered proprietor of the Malaysian brand name used in the advertisement; and
- (iii) the Malaysian brand name goods are of export quality.

A company in the same group that is not the owner of the brand name but has incurred advertising expenditure is not eligible for the deduction.

**Proposed**

The claim of double deduction on expenses incurred for advertising Malaysian brand names be extended to a company within the same group that has incurred the advertising expenditure, subject to the following conditions: -

- (i) more than 50% of the company must be owned by the registered proprietor of the Malaysian brand name; and
- (ii) the double deduction can only be claimed by one company in a year of assessment.

**Effective**

Year of assessment 2007.

**4.7 ENHANCING  
INCENTIVE FOR  
VENTURE CAPITAL**

**Present**

The following incentives are available for venture capital companies (VCCs): -

- (i) income tax exemption for 10 years for investing at least 70% of its investment funds in venture companies (VCs) in the form of seed capital, start-up or early stage financing; or
- (ii) deduction for income tax purposes equivalent to the value of investment made in VCs.

**Proposed**

VCCs investing at least 50% (a reduction from 70%) of its investment funds in VCs in the form of seed capital be given income tax exemption for 10 years.

**Effective**

Year of assessment 2007.

**4.8 INCOME TAX  
EXEMPTION FOR  
ISLAMIC BANKING  
AND TAKAFUL  
BUSINESS**

**Present**

In line with the effort to develop Malaysia as an International Islamic Financial Centre (IIFC), the Government allows Islamic banking and takaful businesses transacted in international currencies to be conducted anywhere in Malaysia. However, such activities are not given any tax incentives.

**Proposed**

Full income tax exemption for 10 years under the Income Tax Act 1967 be given to: -

- (i) Islamic banks and Islamic banking units licensed under the Islamic Banking Act 1983 on income derived from Islamic banking business conducted in international currencies including transactions with Malaysian residents; and
- (ii) Takaful companies and takaful units licensed under the Takaful Act 1984 on income derived from takaful business conducted in international currencies including transactions with Malaysian residents.

**Effective**

Year of assessment 2007 to 2016.

**4.9 TAX EXEMPTION  
FOR COMPANIES  
MANAGING  
FOREIGN ISLAMIC  
FUNDS**

**Present**

Management fees received from foreign investors by licensed foreign fund management companies are subject to income tax at a concessionary rate of 10%.

**Proposed**

Full income tax exemption be given to local and foreign fund management companies for 10 years on the management fees received from managing funds of foreign investors established under the Syariah principles. Such funds must be approved by the Securities Commission (SC).

**Effective**

Year of assessment 2007 to 2016.

**4.10 TAX TREATMENT  
ON EXPENSES  
INCURRED TO  
ESTABLISH  
ISLAMIC STOCK  
BROKING  
COMPANY**

**Present**

Expenses incurred prior to the commencement of a business including a stock broking company are not eligible for any tax deductions.

**Proposed**

Deductions be allowed on expenses incurred prior to the commencement of an Islamic stock broking business, provided the company must commence its business within a period of 2 years from the date of approval by the Securities Commission.

**Effective**

For applications received by the Securities Commission from 2 September 2006 to 31 December 2009.

**4.11 EXTENSION OF  
TAX INCENTIVE  
FOR ISSUANCE OF  
ISLAMIC  
SECURITIES**

**Present**

The tax incentive to allow deduction for expenses incurred on the issuance of Islamic securities based on leasing (Ijarah), progressive sales (Istisna'), profit sharing (Mudharabah) and profit and loss sharing (Musyarakah) will expire in the year of assessment 2007.

**Proposed**

The scope of deduction for Islamic securities is extended to all Islamic securities products approved by the Securities Commission and the incentive be extended to the year of assessment 2010.

**Effective**

Year of assessment 2008 to 2010.

**4.12 TAX TREATMENT  
ON SPECIAL  
PURPOSE VEHICLE  
FOR ISLAMIC  
FINANCING**

**Present**

A Special Purpose Vehicle (SPV) to channel funds is required to be established by a company to obtain financing through the Islamic capital market. The SPV is subject to income tax and is required to comply with all the administrative requirements under the Income Tax Act 1967.

**Proposed**

The following incentives will be given to the company that establishes a SPV solely for the purpose of Islamic financing approved by the Securities Commission: -

- (i) the SPV will not be subject to income tax and is not required to comply with the administrative requirements under the Income Tax Act 1967; and
- (ii) deductions be given to the company that establishes the SPV on the cost of issuance of the Islamic bonds incurred by the SPV. Income received by the SPV will be deemed as income received by the company that establishes the SPV and, be subject to income tax.

**Effective**

Year of assessment 2007.

**4.13 EXTENDING THE SCOPE OF TAX INCENTIVE FOR FINANCIAL INSTITUTIONS**

**Present**

Non-residents are given tax exemption on interest income received from banking and financial institutions established under the Banking and Financial Institutions Act 1989. However, such exemption is not extended to profits and interest income received by non-residents from banking and financial institutions established under the Islamic Banking Act 1983 or other financial institutions.

**Proposed**

Exemption be extended to profits and interest income received by non-residents from financial institutions established under the Islamic Banking Act 1983, and other financial institutions approved by the Ministry of Finance.

**Effective**

2 September 2006.

**4.14 INCENTIVE FOR BANK TO SET UP OPERATIONS OVERSEAS**

**Present**

A bank is taxed on world income scope and hence, its income derived from overseas branch or remittance from its subsidiary abroad is taxable in Malaysia. However, double taxation relief is given for tax suffered by that branch or subsidiary.

**Proposed**

Profits of newly established branches overseas or remittances of new overseas subsidiaries be given income tax exemption for 5 years, subject to the condition that such branch or subsidiary must commence operations within a period of 2 years from the date of approval by Bank Negara Malaysia.

**Effective**

2 September 2006 until 31 December 2009

**5. OTHERS**

**5.1 ADDITIONAL INCENTIVE FOR TOUR OPERATORS**

**Present**

Full excise duty exemption is given to tour operators on national cars used as hire and drive cars.

**Proposed**

Tour operators be given 50% excise duty exemption on locally assembled Four Wheel Drive (4WD) vehicles.

**Effective**

For application received by the Ministry of Finance from 2 September 2006 onwards.

**5.2 REAL PROPERTY  
GAINS TAX -  
CONDITIONAL  
CONTRACT**

**Present**

In the disposal of an asset under a conditional contract, the asset is regarded as disposed at the time of the contract unless the consideration depends wholly or mainly on the value of asset at the time when the condition is satisfied, in which case, the asset is regarded as disposed when the condition is satisfied.

**Proposed**

The date of disposal would be the date of the contract, unless :

- (i) the acquisition or disposal requires the approval by the Government or an authority or committee appointed by the Government, the date of disposal shall be the date of such approval; or
- (ii) the approval referred to in paragraph (i) above is conditional, the date of disposal shall be the date when the last of such conditions is satisfied.

**Effective**

2 September 2006.

**5.3 REAL PROPERTY  
GAINS TAX -  
TRANSFER OF  
TRADING STOCK  
FROM FIXED  
ASSETS**

**Present**

There is no specific tax legislation governing the transfer of assets from fixed assets to trading stocks.

**Proposed**

A specific provision has been introduced under paragraph 17 Schedule 2 to the Real Property Gains Tax Act, 1976 which provides:-

- (i) if an asset acquired or held by a person is taken into the trading stock of the person, there shall be deemed to be a disposal of chargeable asset; and
- (ii) the disposal price of the chargeable asset shall be equal to the market value at the date the asset is taken into stock.

**Effective**

2 September 2006

**5.4 REVIEW OF  
ELIGIBILITY  
PERIOD TO CLAIM  
REFUND OF SALES  
TAX AND SERVICE  
TAX RELATED TO  
BAD DEBTS**

**Present**

Sales tax and service tax paid by the licensee for which payments for goods sold and services rendered have not been received from the client may be refunded provided that such payments are deemed as bad debts and comply with the following criteria: -

- (i) the licensee is unable to collect the debt from the client after the expiry of 12 months from the date of payment of the tax; or
- (ii) the debtor had been adjudged a bankrupt under the Bankruptcy Act 1967; or
- (iii) the debtor had been placed under receivership or official assignee; or
- (iv) the debtor had been ordered by the court to wind up; or
- (v) the licensee had filed a claim in court to recover the tax or the licensee had initiated action for the client to be adjudged a bankrupt;

**5.4 REVIEW OF ELIGIBILITY PERIOD TO CLAIM REFUND OF SALES TAX AND SERVICE TAX RELATED TO BAD DEBTS (Cont'd)**

AND

payments for goods sold have been written off as bad debts in the accounts of the licensee.

**Proposed**

The eligibility period to claim refund of sales tax and service tax related to bad debts be shortened from 12 months to 6 months from the date the tax is paid. This proposal involves amendments to the above criteria as follows:

- (a) criterion (i) - the period to be shortened from 12 months to 6 months; and
- (b) criterion (vi) - introduce a new condition where doubtful debts have been provided in the accounts of the licensee as an alternative to the existing condition of writing off the bad debts.

**Effective**

1 January 2007.

**5.5 REVIEW OF COMPOUND OR FINE FOR UNDER DECLARATION AND SMUGGLING OF HIGH DUTY GOODS**

**Present**

The offences of under declaration of the value of goods and smuggling are punishable as follows:

- (i) compound of not more than 10 times of the duty or value of the goods; or
- (ii) a fine if charged in court and convicted, other than imprisonment sentence, can be imposed as follows: -

	<b>Dutiable goods</b>	<b>Prohibited goods</b>
First offence	a fine of not less than 10 times the amount of duty or RM50,000, whichever is the lesser amount and not more than 20 times the amount of the duty or RM100,000, whichever is the greater amount	a fine of not less than 10 times the value of the goods or RM50,000, whichever is the lesser amount, and of not more than 20 times the value of the goods or RM100,000, whichever is the greater amount
Second or any subsequent offence	a fine of not less than 10 times the amount of duty or RM100,000, whichever is the lesser amount and not more than 40 times the amount of the duty or RM500,000, whichever is the greater amount	a fine of not less than 10 times of the value of the goods or RM100,000, whichever is the lesser amount and of not more than 40 times the value of the goods or RM500,000, whichever is the greater amount

**Proposed**

It is proposed that:

- (i) the minimum compound imposed be 5 times of the total duty; and

**5.5 REVIEW OF COMPOUND OR FINE FOR UNDER DECLARATION AND SMUGGLING OF HIGH DUTY GOODS (Cont'd)**

(ii) the fine imposed be in line with the maximum compound and updated as follows: -

	<b>Dutiable goods</b>	<b>Prohibited goods</b>
First offence	a fine of not less than 10 times the amount of duty and not more than 20 times the amount of duty	a fine of not less than 10 times the value of the goods and not more than 20 times the value of the goods
Second or any subsequent offence	a fine of not less than 20 times the amount of duty and not more than 40 times the amount of duty	a fine of not less than 20 times the value of the goods and not more than 40 times the value of the goods

**Effective**  
1 January 2007.

**5.6 REVIEW OF EXCISE DUTY ON CIGARETTES, TOBACCO PRODUCTS AND ALCOHOLIC BEVERAGES**

The specific excise duty on cigarettes, tobacco products and alcoholic beverages with alcohol content of more than 40% is proposed to be increased as follows: -

Description	<b>Excise Duty</b>	
	<b>Present rate (RM)</b>	<b>Proposed rate (RM)</b>
Cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes	110.00/kg + 20% Or 11 cent/ stick + 20%	120.00/kg + 20% Or 12 cent/ stick + 20%
Tobacco products	14.00/kg – 25.00/kg + 5%	15.00/kg – 27.00/kg + 5%
Beedies	7.00/kg + 5%	7.50/kg + 5%
Alcoholic beverages with alcohol content of more than 40% (Brandy, whisky, gin, vodka and rum)	RM25.00/litre + 15%	RM30.00/litre + 15%

**Effective**  
4.00 pm, 1 September 2006.

**5.7 STAMP DUTY  
EXEMPTION ON  
ISLAMIC  
FINANCIAL  
INSTRUMENTS**

**Present**

To ensure tax neutrality between Islamic and conventional financing products, the additional instruments that are required to be executed in accordance with Islamic principles have been given stamp duty exemption.

**Proposed**

To further encourage the development of Islamic financial sector, it is proposed that 20% stamp duty exemption be given on instruments used in Islamic financing for a period of 3 years. This exemption be given after the stamp duty is exempted for purpose of tax neutrality.

This incentive is subject to the condition that the Islamic financial products are approved by the Bank Negara Malaysia Syariah Advisory Council or Securities Commission Syariah Advisory Council.

**Effective**

2 September 2006 until 31 December 2009.

**5.8 REDUCTION OF  
STAMP DUTY ON  
SMALL AND  
MEDIUM  
ENTERPRISE (SME)  
INSTRUMENTS**

The rates of stamp duty on instrument for “SME”s are reduced as follows:

	<b>Present rate</b>	<b>Proposed Rate</b>
For an amount not exceeding RM250,000 of the aggregate loans or of the aggregate financing under the syariah in a calendar year	RM1.00 for every RM1,000 or fractional thereof	RM0.50 for every RM1,000 or fractional thereof
For each additional RM1,000 not exceeding RM1,000,000	RM5.00 for every RM1,000 or fractional thereof	RM2.50 for every RM1,000 or fractional thereof
For each additional RM1,000 or part thereof	RM5.00	RM5.00

“SME” is defined under section 2 of the Stamp Act 1949 and means –

- (a) in relation to the manufacturing, manufacturing related services and agro-based industries sectors, an enterprise with full-time employees not exceeding one hundred and fifty people or annual turnover not exceeding RM25,000,000; and
- (b) in relation to the services, primary agriculture, and information and communication technology sectors, an enterprise with full-time employees not exceeding fifty people or annual turnover not exceeding RM5,000,000.

**Effective**

2 September 2006.

A publication by : Folks Management Services Sdn Bhd (178398-K)  
Suite 1102, Wisma Tun Sambanthan  
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Printed by : Akitiara Corporation Sdn Bhd  
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