SUMMARY OF TAX CASES

A Malaysian Special Commissioners' Decisions

1.0 TTK V KETUA PENGARAH HASIL DALAM NEGERI (2004) MSTC 3590 (SPECIAL COMMISSIONERS OF INCOME TAX)

Facts

The taxpayer and another shareholder owned 710 shares and 145 shares respectively in a real property company ("the Company"). The Company's only asset is a piece of land which it acquired on 3 February 1994 and incurred a liability of RM938,798.00. The taxpayer increased his ownership of shares in the Company to 855 shares upon acquiring another 145 shares on 27 July 1998.

On 23 August 1999, both shareholders disposed of their 1,000 shares in the Company. In the Sale and Purchase Agreement for the disposal, it was covenanted that the consideration for the purchase of the shares was RM30,295.00 (being the market value of the land of RM 1,000,000.00 less amount owing to creditors of RM 969,705.00) and the Company's liabilities of RM969,705.00 would be discharged as at the date of sale of the shares.

The DGIR raised a real property gains tax assessment amounting to RM39,110.85 in respect of the 145 shares disposed by the taxpayer. The taxpayer disagreed with the assessment raised and lodged an appeal on ground that the amount of RM969,705.00 was to discharge the liabilities of the Company to the taxpayer and did not form part of the consideration for the disposal of the shares. The taxpayer contended that the disposal price of the 1,000 shares in the Company was RM30,295.00.

Issue

Whether the disposal price of the 1,000 shares in the Company was RM1,000,000.00 being the value of the land, the only asset of the company or RM30,295.00, the amount received by the taxpayer and another as shareholders of the Company, being separate from the amount of RM969,705.00 received by the taxpayer to discharge off the liabilities of the Company.

Arguments

Taxpayer

(i) The taxpayer contended that pursuant to the Sale and Purchase agreement, the payment of RM969,705.00 was to discharge the liabilities of the Company and it does not form part of the disposal of the shares.

(ii) The disposal price of the 1,000 shares in the Company received from the purchaser is RM30,295.00.

DGIR

The DGIR contended that the disposal price of the 1,000 shares is RM1,000,000.00, being the consideration agreed by the taxpayer and the purchaser in the Sale and Purchase agreement dated 23 August 1999.

Decision

The taxpayer's appeal was allowed.

The Company owned no other assets other than land. The net value of the Company should represent the value of the shares issued by the Company. In order to determine the net value of the Company, the liabilities of the Company must to be taken into account. The amount of debts owed by the Company to its creditors is the liability of the Company in accordance with the concept of a separate legal entity. Even though the settlement of the debt became part of the Agreement for the disposal of shares, it does not change the fact that the debt is being owed by the Company. It does not become the debt of the shareholders.

In view of the above, the sum of RM 969,705.00 was a debt incurred by the Company and that it was owed to the creditor when the sale transaction took place. The disposal price of the 1,000 shares was therefore RM30,295.00.

2.0 AMC SDN BHD V KETUA PENGARAH HASIL DALAM NEGERI (2004) 3595 (SPECIAL COMMISSIONERS OF INCOME TAX)

Facts

The taxpayer carried on a business of selling cookware, kitchen utensils and water filters to the public through individuals to whom it paid commissions. In addition, individuals who attained certain sales quota levels will receive free trips / tickets to overseas destinations including accommodation.

The DGIR had allowed these expenses as being deductible in the computation of the adjusted income of the taxpayer for the Years of Assessment (Y/A) 1989 to 1992, 1994 and 1995. However, similar expenses incurred for Y/A 1996 were disallowed for the first time on 27 November 1996.

Subsequently, the DGIR disallowed these expenses for Y/A 1989 to 1992, 1994, 1995 and 1997. The notices of additional assessments were raised by the DGIR for the said Y/As on 31 December 1998. The taxpayer appealed against the assessments.

Issue

Whether the expenses incurred by the taxpayer by way of providing free tickets for overseas trips to the individuals who attained sales quotas are expenses wholly and exclusively incurred in its business pursuant to Section 33(1) of the Income Tax Act 1967 (the Act) or whether they are expenses incurred in the provision of entertainment and should be disallowed under Section 39(i)(l) of the Act.

Arguments

Taxpayer

(i) The expenses incurred by the taxpayer are wholly and exclusively incurred in its business and should be allowed as a deduction pursuant to Section 33(1) of the Act.

(ii) The taxpayer had a legitimate expectation that the DGIR would allow the expenses as a deduction and would expect the DGIR to continue to allow the deduction.

DGIR

(i) The said expenses were incurred in the provision of entertainment and should be disallowed under Section 39(i)(l) of the Act as the expenses were given to non-employees.

(ii) There was no element of legitimate expectation as the additional assessments issued were authorized by law and were not against natural justice.

Decision

The taxpayer's appeal was dismissed on the following basis:

(i) There was no contract of employment between the individuals and the taxpayer and there were only sales consultant contracts. The taxpayer did not pay salaries but commissions based on percentage of sales made, did not exercise control on the salesmen except in respect of the terms and procedures of the sales as per the sales consultant contract and did not contribute to EPF or SOCSO for the salesmen. Based on the above evidence adduced, the Special Commissioners concluded that the salesmen were not employees of the taxpayer.

(ii) Since the expenses were given to salesmen who were not the employees of the taxpayer, the expenses would not qualify for deduction pursuant to Section 39(i)(l) of the Act.

(iii) The taxpayer's contention of the doctrine of legitimate expectation is also dismissed as the DGIR had rightly exercised the statutory powers provided.

3.0. I (M) V KETUA PENGARAH HASIL DALAM NEGERI (2005) MSTC 3609 (SPECIAL COMMISSIONERS OF INCOME TAX)

Facts

The taxpayer derived interest income by placing fixed deposits with various banks. Such deposits were placed due to the need to comply with the requirement by the banks for purposes of obtaining financial facilities. Thus, the fixed deposits served as security for the bank facilities. The source of the deposits were internally generated funds of the taxpayer.

The DGIR assessed the interest income from the fixed deposits under Section 4(c) of the Income Tax Act, 1967 as being investment income.

The taxpayer objected against the relevant assessments on the ground that the interest income should be treated as being part and parcel of business profits.

Issue

Whether the interest income was taxable under Section 4(a) as being part of the gains or profits of the business or Section 4(c) as an investment source.

Arguments

Taxpayer

The interest earned was from deposits which were required to be placed as a condition for the granting of borrowing facilities. The decision to place fixed deposits was not a voluntary one and as such, the interest earned is not in respect of an investment made by the taxpayer.

DGIR

The interest income is earned from fixed deposits placed with banks. Interest is a return for the use of funds. The taxpayer placed such deposits and received a return for the funds. Such interest is, therefore, investment income taxable under Section 4 (c).

Decision

The Special Commissioners allowed the appeal on the following basis:

(i) The bank facilities were used for business purposes and the taxpayer was required to place monies in fixed deposits to be charged in favour of the bank facilities.

(ii) The fixed deposits were not voluntarily made. As such, they could not be said to be investments.

(iii) The taxpayer did not have the cash flow to invest via placing fixed deposits. It was compelled to do so and obtained the funds by deferring payments to its sub-contractors and trade creditors.

(iv) The fixed deposits were ancillary to the taxpayer's main activity of being a contractor and as such, were part and parcel of the business activities of the taxpayer.

B Malaysian Courts' Decisions

1.0 KETUA PENGARAH HASIL DALAM NEGERI v. ANEKA JASARAMAI EXPRESS SDN BHD (2005) MSTC 4095 (HIGH COURT OF MALAYA)

Facts

The taxpayer is a company incorporated in Malaysia which operates express bus services on specified routes within Malaysia and between Malaysia and Singapore. Passengers wishing to travel to Malaysia are required to purchase the bus tickets in Singapore through the taxpayer's agents who were based in Singapore. No return tickets were sold in Singapore. For the Years of Assessment 1990 to 1998, the DGIR had assessed the income from sale of bus tickets in Singapore to tax in Malaysia on the basis that it was income "accruing in or derived from Malaysia" under Section 3 of the Income Tax Act 1967 (The Act).

The taxpayer appealed against the assessments arguing that the income from the sale of bus tickets in Singapore was accrued in and derived from Singapore and not Malaysia. Therefore, the income was not taxable in Malaysia.

The Special Commissioners allowed the taxpayer's appeal. The DGIR appealed against the decision of the Special Commissioners.

Issue

Whether the income from the sale of bus tickets in Singapore is income accruing in or derived from Malaysia?

Arguments

Taxpayer

The sale of the bus tickets in Singapore was not income accruing in or derived from Malaysia and was therefore not taxable in Malaysia. This was because the contract for the sale of the tickets was made in Singapore and therefore the source of income is in Singapore.

DGIR

The principal activity of the taxpayer was the operation of express bus services in Malaysia. In addition, since the right to receive the income from the sale of the bus ticket in Singapore arose in Malaysia, the source of income was accrued in or derived from Malaysia and therefore assessable to tax in Malaysia.

Decision

The High Court held that there was sufficient evidence to support the Special Commissioners' findings which showed that:

(i) The sale of tickets took place in Singapore;

(ii) The contract was entered into in Singapore; and

(iii) The money was received in Singapore.

Thus, the High Court upheld the decision of the Special Commissioners in concluding that the income did not accrue in or derived from Malaysia. The appeal by the DGIR was therefore, dismissed.

2.0 PALM OIL R&D BOARD MALAYSIA V PREMIUM VEGETABLE OILS SDN BHD (2005) MSTC 4098 (FEDERAL COURT)

Facts

Premium Vegetable Oils Sdn Bhd (taxpayer) was an oil palm miller engaged in the extraction of crude palm oil (CPO) from the whole fruits and also extraction of crude palm kernel oil (CPKO) from the kernel of the oil palm fruits. The Palm Oil R&D Board Malaysia (PORD) had demanded the payment of cess on the CPKO production pursuant to the Palm Oil Commencement (Research Cess) Order 1979 (the 1979 Order).

The taxpayer contended that CPKO was not crude oil from the oil palm fruits or seeds within the meaning of Section 2 of the Palm Oil Research and Development Act 1979 (the 1979 Act). The PORD, on the other hand, contended that CPKO was crude oil extracted from the seeds of the oil palm, and as such, they had the right to impose cess on CPKO under the 1979 Act.

The taxpayer applied to the High Court for a declaration that no cess was payable on the CKPO. The High Court dismissed the taxpayer's appeal and held that Parliament had clearly intended cess to be payable on all palm oil as can be seen by the words "fruits and seed" in the 1979 Act and "fruits and/or seeds" in the 1979 Order.

The taxpayer appealed to the Court of Appeal and its appeal was allowed. The Court of Appeal held that the imposition of cess is within the meaning of taxing statutes and as such a strict interpretation should be given. One has to look at what is clearly said in the statute. There is no room to look into the purpose, the object or intent for which the Act was legislated. Where there is any ambiguity, it should be decided in favour of the taxpayer. The new Malaysian Palm Oil Board Act 1998 that repealed the 1976 and 1979 Act makes it clear in Section 2 that palm oil includes oil extracted from the kernel of the oil palm fruit. Hence, it is clear that the 1979 Act was to impose cess on palm oil extracted from the fruits and the seeds and not on palm oil extracted from the kernel.

The PORD then appealed to the Federal Court.

Issues

The issues before the Federal Court were :

(i) whether the 1979 Act was a taxing statute; and

(ii) if the answer was in the affirmative, then what interpretation/ approach should be taken; and whether or not the 1979 Order was ultra vires the parent Act, i.e. the 1979 Act.

Arguments

PORD

(i) CPKO is crude oil as defined under the definition of the 'palm oil' under the Section 2 of the 1979 Act.

(ii) There is no ambiguity in the 1979 Act.

Taxpayer

(i) CPKO is not crude oil from the oil palm fruits or seeds as stipulated by Section 2 of the 1979 Act.

(ii) The taxpayer further contended that the following items were ultra vires:

    (a) the absence of any authority in the 1979 Act to collect cess from palm oil millers;

    (b) the levying of cess on CPKO; and

    (c) the unauthorized enlargement of Section 2 and 14 of the 1979 Act by the 1979 Order (i.e. substantive ultra vires).

Decision

The Federal Court dismissed the appeal and affirmed the order made by the Court of Appeal for the following reasons :-

(i) Compulsion is an essential feature of taxation and the element of compulsion was clearly evident in the 1979 Order made under the authority of the parent 1979 Act. Therefore, the 1979 Act was a taxing statute.

(ii) On the construction of a taxing statute, while clear words are needed before a tax can be imposed, what those words are would be interpreted in line with the purposive approach. The principle must be applied in consonance with Section 17A of the Interpretation Acts 1948 and 1967. It was also correct to take the following advice of the privy Council in Margin v Inland Revenue Commissioner (1971) AC 730:

  (a) words were to be given their ordinary meaning;

  (b) one had to look at what was clearly said;

  (c) it might be presumed that neither injustice nor absurdity was intended; and

  (d) the history of an enactment and the reasons which led to its being passed might be used as an aid to its construction.

(iii) Considering Sections 2 and 14(1) of the 1979 Act with paragraphs 1 to 5 of the 1979 Order, the Minister has the power to impose cess on palm oil millers in respect of CPO. However, there was no such power to impose cess on CPKO which is extracted from the kernel and the 1979 Act and the 1979 Order had only made reference to the seed and not the kernel. In the absence of such clear words, it would be unjust and inappropriate to construe the relevant provisions as having the effect of imposing cess on CPKO.

(iv) The interpretation must be expressed in plain and unambiguous language in the particular statute. Section 14(1) of the 1979 Act empowered the Minister to impose research cess on palm oil and not on oil palm millers. If Parliament did not identify the person who was to pay the particular levy, it was not open to a delegate of power to make the identification, such as was made in the 1979 Order. The 1979 Order was therefore ultra vires the 1979 Act and was therefore null and void.

3.0 MR PROPERTIES SDN BHD V KPHDN (2005) MSTC 4119 (HIGH COURT OF MALAYA)

Facts

The taxpayer was carrying on business as a property developer. On 10 April 1984, the taxpayer acquired a few acres of land. In 1990, it sold part of the land at a profit.

The DGIR issued an assessment (dated 2 May 1992) under the Real Property Gains Tax (RPGT) Act, 1976 to subject the profit to tax. Subsequently, the DGIR informed the taxpayer that the transaction should be subjected to income tax instead of RPGT. As such, a notice of assessment dated 9 August 1993 was issued to replace the assessment raised for RPGT.

The taxpayer's appeal to the Special Commissioners of Income Tax was dismissed and it thus appealed to the High Court.

Issues

(i) Whether an assessment could be issued under the Income Tax Act, 1967 to replace an assessment raised earlier under the RPGT Act; and

(ii) Whether the sale proceeds from the land were in the nature of a capital or revenue gain.

Arguments

Taxpayer

(i) The assessment to income tax is null and void as it was issued subsequently to an earlier assessment to RPGT which had been settled.

(ii) The land was purchased for the purpose of investment and the subsequent disposal was a realisation of a capital asset and any gain should be subject to RPGT.

DGIR

(i) The DGIR has the power to review its earlier assessment and can thus issue a new assessment under the Income Tax Act.

(ii) The gain on the disposal of the land is the disposal of an asset in the course of the business of a property developer. The disposal was a trading activity and thus the gain was subject to income tax.

Decision

The taxpayer's appeal was dismissed on the following basis :

(i) The DGIR has the power to review or revise an assessment. As such, the DGIR had vacated the RPGT assessment and issued the income tax assessment. There was no double taxation in respect of the same gain and as such, the income tax assessment was not null or void.

(ii) The evidence indicated that the land was acquired for sale and not for investment. The findings of fact showed that certain indications of trading existed such as the taxpayer's method of financing and the alteration to the land. The taxpayer had failed to rebut the presumption that the land was acquired for trading activity.

4.0 KPHDN V DAYA LEASING SDN BHD (2005) MSTC 4124 (COURT OF APPEAL).

Facts

The taxpayer was engaged in the provision of leasing, factoring and hire purchase financing facilities. There were interest and other expenses incurred by the taxpayer which were common to both its leasing and non-leasing businesses. The dispute revolved around the basis of apportionment of the expenses between the two sources of business income.

The taxpayer had appealed to the Special Commissioners of Income Tax which held in favour of the DGIR. However, the High Court decided in favour of the taxpayer. The DGIR then appealed to the Court of Appeal.

Issue

What should be the basis of apportioning the common expenses between the leasing and non-leasing businesses?

Arguments

DGIR

The common expenses should be apportioned by taking into account what is the gross income of the leasing business (i.e. the entire lease rental) and the gross income of the non-leasing business (i.e. the interest portion).

Taxpayer

(i) For the purpose of apportionment, only the interest element should be taken into account when referring to the gross income of the leasing business as this is in line with the manner of ascertaining the gross income of the non-leasing business. Therefore, the capital element in the gross lease rental should be ignored.

(ii) The Leasing Regulations 1986 only refers to what is to be treated as gross income from a leasing business and it does not address the issue of apportionment of common expenses.

Decision

The Court of Appeal allowed the appeal by the DGIR and held that in apportioning common expenses to the leasing business, the following formula should be used:

$$\frac{\text{Gross income from Leasing (i.e. principal and interest)}}{\text{Gross income from leasing (i.e. principal and interest)} + \text{Gross income from other sources (i.e. interest)}} \times \text{Common Expenses}$$

The Court held that the relevant provisions of the Income Tax Act must be read together with the Leasing Regulations, 1986. It held that, in the case of a leasing business, the gross income is the principal and interest and that is applicable in ascertaining the adjusted income of the taxpayer.