TAX CASES

1. Profit from Sale of Shares in a Property Development Company Not Subject to Real Property Gains Tax

In *Binastra Holding Sdn Bhd v KPHDN (Civil Appeal No. R2-14-8 of 2000)*, the taxpayer, a holding and investment company, acquired a total of 75,000 shares (at RM1 per share) in Sukma Persona Sdn Bhd ("SPSB") which was in the business of developing property from 15th June, 1996 to 27th July, 1996. SPSB was then the registered owner of land which were alienated to it by the Selangor State Government for purposes of development and sale as housing units. This land was subsequent converted for housing development.

On 6th April, 1998, the taxpayer sold its 75,000 shares in SPSB to a purchaser for RM600,000. The IRB assessed the taxpayer on this under paragraph 34A, Schedule 2 of the *Real Property Gains Tax Act 1976* ("RPGT Act"). The taxpayer's appeal to the Special Commissioners of Income Tax (SCIT) was dismissed. The issue before the High Court was therefore, whether the gains made by the taxpayer from the disposal of the shares within the ambit of the RPGT Act.

Where the taxpayer bought shares in SPSB on 25th June, 1996, it had already acquired the property to be developed on 7th June, 1995. Thus the gains made under the disposal of the shares placed it outside the ambit of paragraph 34A, Schedule 2 of the RPGT Act.

The subject land was subdivided into separate individual titles for sale with buildings thereon as stock-in-trade, due to SPSB's activities in working on and maturing the land. The asset of SPSB in this instance, was not real property comprising land, but stock-in-trade. As such, RPGT cannot be imposed since there was no chargeable asset under the RPGT Act. Paragraph 34 also purports to equate the shares of a company with the character of its assets. Since the character of the assets here was not real property, SPSB could not be a real property company and so, the RPGT Act did not apply.

For a "gain" to be taxable under the RPGT Act, a company must be a real property company as determined by paragraph 34A, Schedule 2 of the RPGT Act. However, it must first be determined whether the gain of the stock-in-trade was liable to income tax. If it did, and so taxable under the Income Tax Act 1967 ("the Act"), it was not to be taxed as a "gain" under the RPGT Act.

2. Compensation Paid for Early Retirement is Taxable

In *Ho Soon Guan v KPHDN (Civil Appeal No. R1-14-3-99)*, the taxpayer worked for his employer, a bank which offered a separation scheme, ("the Scheme") that provided for early retirement with payment of benefits. Officers were invited to apply to the Scheme.

The taxpayer applied to join the Scheme. When he applied to join the Scheme he had taken a special post with the bank which was lower than that which he had occupied before, because he was afflicted with polymyositis which necessitated him having to wear a neck collar. His application was approved and he left the service of the bank about one year before he was actually due to retire. On retirement under the Scheme,

he was paid RM390,437 as "compensation for loss of employment". The Inland Revenue Board (IRB) imposed a tax of RM113,021.60 on this amount.

The taxpayer argued that he was exempt from tax because of ill health under paragraph 15(1)(a) of Schedule 6 to the Act. The IRB refused to allow an exemption but instead awarded a reduction of RM4,000 per annum pursuant to paragraph 15(1)(b) of Schedule 6 to the Act. The SCIT ruled that the taxpayer's loss of employment was a choice made by the taxpayer when he participated under the Scheme and not because of health reasons. However, the SCIT ruled that the compensation qualified for the exemption of RM4,000 for each completed year of service under paragraph 15(1)(b) of Schedule 6 to the Act.

The taxpayer appealed to the High Court which confirmed the finding of the SCIT which was not wrong in law.

3. Bus Ticket Sold in Singapore for a Journey to Malaysia Not Taxable

In *AJE Sdn Bhd v KPHDN (Appeal No. PKCP(R) 52/99)*, the taxpayer, a company incorporated in Malaysia operates an express bus service which served different parts of Malaysia. For routes that ended at Johor Bahru, approval had been granted by the relevant authority of Singapore to operate the buses in Singapore. For the entire journey from Singapore to Kuala Lumpur, Ipoh or Penang, passengers embarking the buses in Singapore bought tickets in Singapore. These tickets were sold by the taxpayer's agents in Singapore. The taxpayer did not sell return tickets in Singapore. However, return tickets were sold in Malaysia for the journey from Malaysia to Singapore and this income was treated as Malaysian income in the taxpayer's accounts. Income from the sale of tickets in Singapore and Malaysia and their respective costs of operations were separately reflected in the accounts. The taxpayer was assessed in respect of income from the sales of the tickets in Singapore as well as income for the sales of tickets in Malaysia.

The issue before the SCIT was whether the taxpayer's income from the sales of bus tickets in Singapore in the relevant years was income accruing in or derived from Malaysia under Section 3 of the Act.

The appeal by the taxpayer was allowed by the SCIT on the grounds that :-

(a) For income to be chargeable to Malaysian tax, the income should be accruing in or derived from Malaysia, or received in Malaysia from outside Malaysia. There was no evidence that the profits derived from the sale of tickets in Singapore were received in Malaysia.

(b) On the evidence adduced, the income accrued in Singapore and was not derived from Malaysia. The contract was also entered into in Singapore.

(c) Section 3C of the Act provides that tax shall not be charged on income arising from sources outside Malaysia.

(d) In the light of Section 12(1)(a) of the Act, there was the issue of whether the income earned in Singapore by the sale of tickets to passengers travelling from Singapore to Malaysia by express buses belonging to companies incorporated in Malaysia fell within the ambit of the words "so much of the gross income from the business carried on outside Malaysia" in the provision. Considering the ambiguity in the statutory language and the tenable alternative interpretation, the interpretation most favourable to the taxpayer was to be adopted.

The Director General of Inland Revenue (DGIR) had appealed to the High Court against the decision made by the SCIT.

4. Acquisition Price and Date of Acquisition of Bonus Shares

In *SYPM Sdn Bhd v KPHDN [(SCIT) Appeal No. PKCP (R) 59/99]*, the taxpayer acquired 80,000 shares in a real property company, Syarikat AE Sdn Bhd ("the company") on 29th December, 1994. Subsequently, on 16th January, 1997, the taxpayer acquired 1,920,000 bonus shares in the company. Thereafter on 15th December, 1997, the taxpayer disposed 2,000,000 of the shares in the company for RM2,000,000.

The DGIR applied Section 7(1)(c) of the RPGT Act and determined that there was no tax payable in respect of the acquisition of the 80,000 shares because there was neither a chargeable gain nor an allowable loss. However, in respect of the 1,920,000 shares, the DGIR applied Section 7(1)(a) read together with paragraph 4 and 34A(3), Schedule 2 of the RPGT Act and arrived at a chargeable gain of RM1,920,000 and raised an assessment of RM596,000 inclusive of a penalty of RM20,000.

The taxpayer argued that the shares were acquired before the amendment was made to paragraph 34A(3), Schedule 2 of the RPGT Act on 17th October, 1997. On that basis, there was an allowable loss of RM483,015.60 resulting in no chargeable gain.

The DGIR on the other hand, contended that paragraph 34A(3), Schedule 2 of the RPGT Act, before its amendment on 17th October, 1997, cannot be applicable in respect of the disposal of the shares as such disposal took place after the coming into force of the amended provision.

The SCIT dismissed the appeal by the taxpayer and held that the amendment to paragraph 34A(3), Schedule 2 of the RPGT Act was not retrospective and apply to all disposal of shares after the effective date of 17th October, 1997, irrespective of the date of acquisition.

5. Disposal of Land by a Property Development Company Subject to Income Tax

In *M Holdings Sdn Bhd v KPHDN [(SCIT) Appeal No. PKCP (R) 56/99]*, the taxpayer was a company with its principal activity in property development. Pursuant to a joint venture agreement, a piece of land ("the subject property") belonging to Selangor Industrial Corporation Sdn Bhd ("SIC") was injected into the taxpayer's accounts in 1989 at a cost of RM25 million. The subject property was used as a car park until 1995. The subject property was classified as "fixed assets" in the taxpayer's accounts for the years ended 31st January, 1990 and 1991. For the subsequent 3 years, the subject property was shown under "current assets". All development expenditure was shown as "current assets". There was no physical development on the subject property. However, for the year ended 31st January, 1995, the subject property was shown as "investment property" in the accounts.

The subject property was subsequently sold on 11th April, 1995, 4 days after the signing of the accounts by the taxpayer's directors and auditors. Thereafter the taxpayer submitted a Return of Disposal of Chargeable Asset under the RPGT Act and an assessment (RPGT) was raised accordingly. This assessment was subsequently substituted with one under Section 4(a) of the Act. The taxpayer was dissatisfied with the later assessment.

The issue before the SCIT was whether the gains made by the taxpayer from the disposal of the subject property was assessable to income tax or RPGT. If the gains were subject to income tax, whether the cost to the business should be the market price of the subject property at the time of the transfer of the property from fixed assets to the current assets account. Further, whether RM2 million which was part-payment to SIC for the subject property should be deducted in arriving at the adjusted income of the taxpayer. Besides that, can the DGIR maintain two assessments, one raised under the Act and the other under the RPGT Act.

It was held by the SCIT that:-

a) the clauses in the joint venture agreement clearly indicated that the taxpayer's intention from the start was to develop the property for sale. From the taxpayer's act and conduct and the description of the company as property developer, the facts indicated that the intention of the taxpayer when it acquired the subject property was that of "an adventure in the nature of trade". Hence, the gain was assessable under Section 4(a) of the Act.

b) the taxpayer's argument that the market price of the subject property at the time of the transfer of the property to the current account must be taken as cost to the business was not acceptable as there was evidence suggesting that the object of the joint venture was to develop the property for sale.

c) the RM2 million was paid to SIC after the subject property was sold, that is, from the proceeds of sale. It therefore amounted to distribution of profit and therefore not revenue in nature. It was also not incurred in the production of gross income and therefore not tax deductible.

d) the DGIR has rectified the error for the assessment raised under the RPGT Act by substituting it with one under the Act and hence no two assessments were maintained.

6. Malaysians Performing Overseas Duties Entitled to Unilateral Tax Credit

In *LCC V. KPHDN [(SCIT)(Appeal No. PKCP(R)86/99* the taxpayer was a Malaysian citizen employed by a local company, ITSB. During the basis year for the year of assessment 1997, he was a tax resident in Malaysia. As part of his employment with ITSB, he performed overseas duties in the United States of America (“USA”) for 302 days in that year of assessment. While the taxpayer was in USA, his salary was paid by ITSB into his bank account in Malaysia. The taxpayer’s income was subjected to tax both in Malaysia and USA. On this account, the taxpayer contended that “income from an employment exercised outside Malaysia” in paragraph 15, Schedule 7 of the Act refers to income in respect of an employment pursuant to which the employee performs duties outside Malaysia and thus he is entitled to a unilateral tax credit under Section 133 of the Act. The IRB however, contended that notwithstanding the double tax in respect of the taxpayer’s income, that phrase “income from an employment exercised outside Malaysia” refers only to foreign income. Since the taxpayer’s income was banked into his Malaysian account, it could not constitute foreign income, thus disentitling the taxpayer to the credit.

The SCIT allowed the taxpayer’s appeal as they found that the provision was specific to employment income in respect of an employment exercised outside Malaysia involving Malaysian as well as foreign tax. As such, the taxpayer was entitled to the unilateral tax credit.

7. Grossing-Up of Amount for the Purpose of Withholding Tax Not Deductible

In *EPM Inc v KPHDN [Appeal No. PKCP(R)25/99]* the taxpayer was registered in Malaysia as a branch of a foreign company. It was in the business of exploration, development and production of petroleum. In the years 1986 to 1990, the taxpayer incurred costs when it underwent some restructuring exercise. It also made payments to its various affiliates for services rendered. The terms of the payment required that the invoices be paid in full. To achieve that, the taxpayer agreed with its service providers they should gross up their bills so that after deduction of any withholding tax, the service providers would still receive the full amount. The amount of withholding tax was then claimed as a deduction. In 1993, the DGIR conducted an investigation and in December 1997 and December 1998, the taxpayer was served with notices of additional/reduced assessments. The taxpayer objected to these notices of additional assessments.

The issues before the SCIT were:-

(a) whether the DGIR was correct in disallowing the deduction being withholding tax deducted and remitted to the DGIR and bringing this amount to charge as additional income;

(b) whether the DGIR is correct in treating all service charges paid by the taxpayer to its affiliates as falling within Section 4A of the Act. In this respect, the taxpayer had split up invoices into technical and non-technical and withheld tax only for payment which was classified as technical;

(c) whether the restructuring costs consisting of employee separation cost, relocation cost and facilities cost are tax deductible;

(d) whether the DGIR is debarred from raising the assessments for years of assessment 1984 and 1985 which are beyond the 12 years limit under Section 39 of the *Petroleum Income Tax Act, 1967 (PITA)*.

The appeal by the taxpayer was dismissed by the SCIT on the grounds that:-

a) there is no basis or provision for grossing up under both the Act and PITA. The additional deduction was also not any cost of production and was therefore not deductible under Section 15(1) of PITA. Instead it was part of the amount of withholding tax, and tax, in whatever form, did not qualify for deduction. Furthermore, withholding tax is not income tax of the payer but tax of the recipient. Therefore, it is not an allowable expense under Section 15(1) of PITA / Section 33(1) of the Act.

b) Section 4A(ii) of the Act covers the two types of assistance or services and does not provide for splitting up of invoices into technical and non-technical. It was evident from the facts that the DGIR was correct in treating all service charges paid to the taxpayer's affiliates as falling within the scope of Section 4A of the Act except those service charges related to service, management and administration agreements provided to the taxpayer as they concerned day to day operations.

c) the restructuring costs in this case were not wholly and exclusively incurred in the production of gross income of the taxpayer. On the contrary, the facts showed that the restructuring costs incurred were not for the taxpayer itself but for the Head Office.

d) the DGIR could raise assessment or additional assessments in respect of the years beyond the 12-year period if as the evidence available in the case revealed that the taxpayer had intentions to commit fraud or willful default and in some instances negligence committed by the taxpayer.

8. Dividend and Interest Income Cannot be Split by Treating Each Counter of Share Investment or Loan As a Separate Source

In *KPHDN V M P Holdings Sdn Bhd (Civil Appeal No R1-14-12-98),* the taxpayer was a holding and investment company. It received income from the following:-

a) dividend income from the holding of shares in various companies;

b) interest income from the giving of loans to related companies and from the placing of funds on short-term deposits;

c) rental and plantation income.

The IRB treated each counter of the share investment, each loan given and each deposit placed by the taxpayer as a separate source of income. The taxpayer argued that for the purposes of arriving at the adjusted income under Section 33 of the Act, dividend income and interest income for each year of assessment should be treated as distinct and singular sources of income however or from wherever derived.

The SCIT agreed with the taxpayer and ruled that the IRB could not further sub-divide each source by treating each counter of share investment as a separate source or apportion the dividend between income producing and non-income producing. Consequently, the SCIT found that all counters of shares whether income producing or non-income producing were a single source of income under Section 4(c) of the Act and that the same principle applied to interest income.

On further appeal to the High Court, it was ruled that the IRB had no authority to split the classification of income by treating each counter of share investment, each loan given and each placement of deposit as a separate source of income.

9. Interest Income Taxed As a Section 4(a) Business Source

In *KPHDN V P C Edible Oils Sdn Bhd [Civil Appeal No. W-01-200, 1997),* the taxpayer was involved in the business of refining and processing palm oil. The price of crude palm oil, the raw material for its business fluctuated from time to time and hence the amount of cash needed to purchase the crude oil varied from time to time.

The amount of cash from the proceeds of sale of its products was needed to be readily available for the purchase of the crude palm oil. When the price of crude palm oil dropped, less cash was needed to fund the purchase and when its price went up, more cash was needed for the purpose. When less cash was needed to fund the purchase, the excess cash was placed on short term and long-term deposits and on Negotiable Certificates of Deposits. The short term deposits were all for very short terms on 30 days or 1 day call. The placing of deposits and lifting of deposits were continued on a regular and repetitive basis.

The issue of determination was whether interest income derived from the short and long term deposits was business income under Section 4(a) or was interest income under Section 4(c) of the Act. The effect of the classification is pertinent in this case because the brought forward business losses of the taxpayer can be utilized to offset against its interest income if it is treated as a Section 4(a) business source.

The taxpayer contended that interest income from the short term and long term deposits is part and parcel of its business income or ancillary to its business or it is business income arising out of an adventure or concern in the nature of a trade.

After having considered that the motive for the deposits was the intention to make profits for the company using idle funds or excess cash, the SCIT held that the interest income satisfied the criteria envisaged in order to qualify as business income or alternatively, as income from an adventure or concern in the nature of trade.

On appeal to the High Court by the IRB, the High Court held that in the case stated there was nothing ex facie which was bad in law and that could have tilted the balance in favour of the IRB and thereby confirmed the decision of the SCIT.

The IRB pursued the appeal with the Court of Appeal. Having reviewed the findings of primary facts made by the SCIT, the Court of Appeal agreed with what was summarized by the learned judge on the facts as found.