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CHARTERED TAX INSTITUTE OF MALAYSIA (225750-T)

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TO ALL MEMBERS

TECHNICAL

Direct Taxation

TAX CASE UPDATE

Whether section 140(1)(a) of the Income Tax Act 1967 (ITA) applied to the Appellant and whether the penalty under section 113(2) of the ITA was automatically imposed on the Appellant by the Respondent. **[Statutory Ref.** Sections 140 and 113(2) of Income Tax Act 1967 (ITA)**]**

***Syarikat Ibraco-Peremba Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri* (2014)**

(Court of Appeal) (Civil Appeal No: W-01-177-04/2013)

Date of Judgment: 29 May 2014

Facts:

The Appellant, Syarikat Ibraco-Peremba Sdn Bhd (SIP), is a property development company. Income from its activities of buying, developing and selling land is regarded as business income subject to tax under the ITA. In 1992, it identified certain parcels of land in Kuching (referred to as "the Lands") as being suitable for long term investment. It intended to build shophouses on the Lands, as well as on another lot of land which it owned, and to lease out the shophouses for a period of time prior to sale (the Lands together with the completed commercial buildings hereinafter referred to as "the Properties").

SIP was advised by its tax consultant to set up a subsidiary and thereafter to sell the Lands to the subsidiary. Pursuant to the advice, a wholly-owned subsidiary, Ibraco-Peremba Holdings Sdn Bhd (IPH) was set up in 1994. After sale of the Lands to IPH, SIP entered into the Turnkey Construction Contract with IPH to develop the Lands, which project was completed in 1996. On completion, the properties were rented out and the rental income declared as business income of IPH.

In 2003, SIP sold its shares in IPH to Vendu Sdn Bhd, a company held by Ibraco Bhd. (60.5%) which was a related company of SIP, and Peremba Holdings Sdn. Bhd. (39.5%) for the consideration of RM22.5 million. Following that, IPH sold the Properties in 2003 and 2004, realizing a gain of RM16.9 million. The gain was calculated based on the value of IPH shares sold to Vendu (RM22.5 mil.), from which amount was deducted SIP's investment cost in IPH shares (RM5.6 mil.). Both IPH and Vendu were later voluntarily wound up.

The Respondent, Ketua Pengarah Hasil Dalam Negeri, then reviewed the method of determining profit of SIP and, based on the new method, the net profit of SIP was determined to be RM13,518,620. This is obtained by deducting the development cost incurred on the project (RM15,621,380) from total value of the disposal (RM29,140,000). Additional assessment was raised on SIP to which SIP objected, and appealed to the SCIT to determine whether the amount of chargeable income arrived at was correct.

Before the SCIT, SIP submitted that it had only disposed of shares in IPH, which was a realization of investment and not an adventure in the nature of trade or trading. Gains (if any) from disposal of shares in a real property company should be taxed under the Real Property Gains Tax Act 1976 (RPGT Act) but SIP should not be held liable to pay tax on the profit made by its subsidiary.

It was SIP's contention that the Respondent was not justified in invoking section 140 of the ITA.

The Respondent contended that based on the facts and the law, the Respondent had correctly exercised its discretion to invoke section 140 of the ITA, whereby disposal of the Lands to IPH had been disregarded and adjustment was made to tax the proceeds from the sale of the Properties as income of SIP. The Respondent had also correctly exercised its discretion to impose penalty under section 113(2) of the ITA.

The SCIT dismissed SIP's appeal and held that the Respondent was right to invoke section 140 of the ITA, and that the chargeable income of RM RM13,518,620 was arrived at correctly. They also held that the imposition of penalty by the Respondent under section 113(2) of the ITA was correct in law. SIP then appealed to the High Court, which upheld the decision of the SCIT, ruling that the facts found by SCIT were unassailable and could not be overruled. The High Court also held that there was no error committed by the SCIT to warrant interference by the High Court as there were evidence and facts to support the findings of the SCIT.

Hence, this appeal to the Court of Appeal (referred hereinafter as "the Court") against the High Court's decision

Issue:

The issues to be determined were:

1. Whether section 140(1)(a) of the ITA applied to SIP;
2. Whether the penalty under section 113(2) of the ITA was automatically imposed on SIP by the Respondent.

Decision:

Appeal dismissed, decision of High Court affirmed.

The following are some salient points in the Judgment:

Role of an Appellate Court in a Tax Appeal

Before discussing the issues of the case at hand, the "Role of an Appellate Court in a Tax Appeal" was discussed with references to previous decided cases (e.g Chua Lip Kong v. DGIR; Edwards v Bairstow and Harrison) focusing on principles as enunciated in the Edwards case, relating to the circumstances which warrant intervention by the Appellate Court, such as the following:

- *"the case contains anything ex facie which is bad law and which bears upon the determination…."*
- *"the facts found are such that no person acting judicially and properly instructed as to the relevant law could have come to the determination under appeal."*
- *"…there has been error in point of law."*

(A) Section 140 of the ITA

1. The Judge made the following observation relating to the application of section 140 of the ITA:

   "*the distinction between what is accepted and what is not in the way of reducing the amount of tax to be paid used to be conveniently described by the terms tax avoidance and tax evasion respectively. Section 140(c) of the Act in particular, has the effect of demolishing that convenient description. The Act now empowers the Director General,……where he has reason to believe that any transaction has the direct or indirect effect of evading or avoiding any duty or liability which is imposed or would otherwise have been imposed on any person by the Act, to disregard or vary that transaction or make*

such adjustments as he thinks fit with a view to counteracting…..such…effect of the transaction."

*"Thus the oft quoted words (from) …**IRC v Duke of Westminster**…that every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Act is less than it otherwise would be is now only partially true, for whether he succeeds or not, according to section 140(c), depends upon the determination of the Director General. We make the observation that it is for the taxpayer to demonstrate that the transaction or arrangement…….was so preordained by compliance with the requirements of the law or accepted business practices to limit risk exposure, and that the tax savings were purely incidental."*

2. After a careful perusal of the facts as found by the SCIT, the Court agreed with the view of the High Court Judge that those findings of facts should not be disturbed, and held the view that there is no error of law committed when the Judge dismissed SIP's appeal and affirmed the SCIT's Deciding Order.

3. It was quite clear that the advice of SIP's tax consultant (the Tax Consultant) was obtained for the primary purpose of ordering the transaction in a manner to minimize tax. The Court found that based on the factual matrix of this case the learned High Court Judge was not wrong in coming to her conclusion that the facts found by the SCIT showed that there was tax avoidance when the transactions entered into by SIP through the shell companies revealed the factual situation that the tax position was altered; that the SCIT had found that SIP had in fact implemented a scheme following the advice of the Tax Consultant in perpetuating one original intention of selling of the Properties as it intended to do from the start. The High Court Judge referred to the principle from W.T.Ramsay Ltd v IRC that in looking at tax avoidance scheme which comprised a number of specific transactions to avoid tax, the genuineness or otherwise of each individual step or transaction need not be looked at from each individual step or transaction but is to be looked at as a whole. As such the learned Judge found that no error was committed by the SCIT to warrant intervention by her as there were evidence and facts to support the SCIT's findings in arriving at their decision that the case fell under section 140 of the ITA. The Court agreed with the learned Judge's reasoning and conclusion.

4. The Court also accepted the SCIT's findings of facts that the "second and third transactions" (referring respectively to the sale of IPH shares to Vendu, and the sale of the Properties by IPH to third parties) were in discharge of the scheme advanced by the Tax Consultant as a way of avoiding tax by SIP, which proposed scenario did envisage a "relatively long period (of about) 5 years" (as stated in the Tax Consultant's letter of advice to SIP) before the Properties could be disposed of. The passage of time is of little consequence in the scheme of things for SIP when the Court takes into account the findings of facts by the SCIT and the matters highlighted by the Respondent.

For the above reasons, the Court affirmed the High Court's decision affirming the SCIT's decision that section 140(1)(a) of the ITA applied to SIP.

Note

The observation by the Court of Appeal relating to section 140 of the ITA which is quoted above under point (1) should be taken note of, particularly "the observation that it is for the taxpayer to demonstrate that the transaction or arrangement…….was so preordained by compliance with the requirements of the law or accepted business practices to limit risk exposure, and that the tax savings were purely incidental." This burden of proof now to be borne by the taxpayer must be taken into consideration in the implementation of any tax saving scheme.

(B) Penalty under section 113(2)

1. There is no doubt that section 113(2) of the ITA, gives discretion to the Respondent to impose a penalty on a person who submits an incorrect return or gives incorrect information. Although the words of section 113(1) are almost identical to section 113(2), it differs from the latter in that section 113(1) provides for the defence of "good faith" *("unless he satisfies the court that the incorrect return or incorrect information was given in good faith*") which is not found in section 113(2). Also, section 113(2) applies under circumstances which are different from section 113(1), i.e. in a situation where no prosecution under section 113(1) has been instituted. That being the case, the defence of "good faith" as found in section 113(1) does not apply to the Director General's discretion under section 113(2). Therefore the Court disagreed with SIP's submission that the SCIT had erred in the interpretation of section 113(2) in holding that "good faith" was not a defence.

2. The Court also disagreed with SIP's submission that as section 140 of the ITA did not provide for a penalty, the Respondent was precluded from invoking it under section 113(2). It is self evident that section 140 does not expressly nor impliedly exclude the operation of section 113. Section 140 gives the discretion to the Respondent in certain circumstances and does not relate to a question of breach by SIP as such. Neither do the provisions of section 113 exclude its application in the circumstances provided for under section 140. Section 113 therefore operates in the circumstances stipulated therein independent of section 140. Hence the Court did not find the Respondent had erred in invoking section 113(2) against SIP.

3. The SCIT had considered the Respondent's submission that if not for the fact that "*it had stumbled upon the (Tax Consultant's) tax advice*" as a result of an investigation on SIP, "*the scheme would never have seen the light of day*". In not intervening in the issue of penalty, the learned High Court Judge seemed to share the same view. The Court also shared the same view and saw no need to intervene.

Note

It should be noted that the Respondent had submitted before the Court: "If the scheme is ruled as unacceptable scheme, it was submitted that the Appellant had furnished an incorrect return for failure to disclose all the proceeds from the disposal of the said Properties and had given incorrect information in relation to the matter affecting its own chargeability to tax. .. Further, the scheme was never communicated to the Respondent and if there was no investigation carried out by the Respondent, the scheme would never have been discovered. Therefore, failure to disclose such a scheme was an important consideration in the imposition of the penalty. Learned counsel for the Respondent referred back to Challenge Corporation Ltd (supra) for the proposition that failure to inform all facts relevant to an assessment can tantamount to tax evasion and not avoidance. In view of all the relevant facts and circumstances of the case, it was submitted that as the Appellant had made an incorrect return and information to the Respondent, the Respondent was correct in imposing a penalty under section 113(2) of the Act."

Members may read the full Grounds of Judgment from the Official website of the Office of Chief Registrar, Federal Court of Malaysia.