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TECHNICAL

Direct Taxation

TAX CASE UPDATE

Appeal against the IRBM's disallowance of claim for tax relief by holder of a Pioneer Certificate

KPHDN v LATEX MANUFACTURING SDN BHD

High Court of Malaya at Kuala Lumpur
Civil Appeal No: 14-1-01/2015
Date of Grounds of Judgment: 10 May 2016
Date of Decision: 8 August 2015

Facts and Issues:

The respondent ("the taxpayer") is a company carrying on a business of manufacturing natural or synthetic rubber gloves. It was issued with a Pioneer Certificate ("the PC") dated 4.5.1993 by the Minister of International Trade and Industry by which it gained pioneer status that commenced on 1.10 1992. The pioneer status was extended for 5 years from 1.10.1997 to 30.9.2002. The PC contained a condition that "*Syarikat ini hendaklah mengeksport keseluruhan pengeluarannya*".

Self assessment for companies was introduced from the year of assessment (YA) 2001. As a result of a tax audit conducted by the IRBM (the appellant) on the taxpayer, the taxpayer was informed via a letter from the appellant dated 6.7.2010, that it was a condition of the pioneer status incentive that the taxpayer must directly export its production, and that the taxpayer had failed to comply with this condition. Due to this "failure", the appellant raised an assessment on the taxpayer for the YA 2000 (Current year basis) which was computed without granting any incentive and this was notified via the *Notice of Assessment (Form J) for YA 2000 (CY) dated 24.9.2010**. Tax payable under this notice amounted to RM4,562,703.04 while penalty imposed (at the rate of 45%) under S113(2) of the Income Tax Act 1967 (ITA) amounted to RM2,053,216.37. (All provisions cited hereafter refer to sections in the ITA, unless otherwise stated.)

* CTIM's Note – This fact (Form J… dated 24.9.2010) which is mentioned in para.3.10 of the Judgment, is not in accord with what is stated in para. 2.1 of the Judgment, which states that the relevant notice of assessment (under appeal) is "a Notice of Additional Assessment (Form JA) dated 24.9.2010". There is no explanation for this discrepancy in the Judgment. (Refer to Issue 1 of issues for determination by the SCIT below.)

Aggrieved by the assessment, the taxpayer appealed to the Special Commissioners of Income Tax (SCIT). The issues which were agreed by the IRBM to be determined by the SCIT were (stated in brief) as follows:

1. Whether the additional assessment for the YA 2000(CY) made via *a Notice of Additional Assessment (Form JA) dated 24.9.2010* was time-barred under S91(1).
2. Whether the appellant had fulfilled condition (j) in the PC by exporting its production directly as well as through its holding company and other exporters.
3. Whether the penalty imposed for YA 2000(CY) was "correctly and reasonably" imposed.

Among the "Proved Facts" found by the SCIT are the following:

(a) The appellant's interpretation of condition (j) of the PC is a very narrow one, deliberately taken to penalize the taxpayer with tax.

(b) The taxpayer had ensured that all products are exported, be it directly or indirectly via its holding company.

(c) The reason for exporting via the holding company was for risk management purposes. It was not to enable the taxpayer's holding company to make a profit.

(d) If the taxpayer's products were not exported, sales tax would need to be charged to the products sold locally. However, records (provided by the Customs Department) showed that products not exported are only 0.0064% of the taxpayer's total sales.

(e) The production of the taxpayer's products are undeniably focused on export.

(f) As such, the taxpayer has not contravened Condition (j) of the PC at all material times.

The SCIT decided in favour of the taxpayer. Hence the present appeal to the High Court ("the Court")

Decision:

The High Court decided in favour of the taxpayer on all of the 7 issues that were addressed by the Court.

The grounds for reaching the decision in respect of each of these issues are summarized below.

Issue 1*- Whether the appellant is vested with the authority to disregard the PC and Pioneer status of the taxpayer for any YA, in which a condition in the PC was allegedly not complied with.*

1. The SCIT had made the following findings of fact:

(a) The appellant had failed to seek clarification with the taxpayer in regard to the reasons that the sale was made through the holding company. The appellant had informed MITI (via a letter dated 17.7.2009) that the taxpayer had not exported all of its products on its own and advised MITI to cancel the PC granted to the taxpayer. However, there were no supporting documents and the person who wrote the letter was not acquainted with the facts of the case and was not in charge of the audit of the taxpayer's account. Even the fact that export was indirectly done through the holding company was not made known to MITI and no clarification was sought from MITI with regard to whether export of its products must be done by the taxpayer only, or may be carried out by other persons so long as the products leave this country.

(b) MITI had not contacted the taxpayer or issued a notice in writing as required under S9(1) of the Promotion of Investments Act 1986 (PIA), to require the taxpayer to show cause why the PC should not be cancelled. The taxpayer "was left in the dark" about the communications between IRBM and MITI until much later. Hence, the taxpayer was not given the opportunity to present its case and the IRBM did not inform MITI of the fact pertaining to the export made through the holding company. As such, MITI was not fully apprised of the facts.

(c) The appellant was not the proper authority to decide whether exports made through the holding company satisfied the requirement in condition (j) of the PC. This fell within the purview of MITI. The SCIT was of the view that the appellant had exceeded his authority.

(d) The appellant had no legal basis to raise additional assessment on the taxpayer. Under S24 of the PIA, it may raise additional assessment only if there is a direction under S17 of the PIA or if the PC has been cancelled. As neither of these events has occurred, the appellant had no authority to raise additional assessment. S24 of the PIA, being a specific law overrides the provision of S91.

Based on the above, the Court found that the appellant was wrong in issuing additional assessment and the SCIT was justified in arriving at their decision as the mandatory procedure of

S24 of the PIA had not been complied with. As the PC had not been cancelled the taxpayer can continue to enjoy its pioneer status.

Issue 2 *– Non-compliance of the Mandatory Requirement under S9 of PIA.*

1. S9 of the PIA imposes a mandatory requirement for a notice in writing to be issued to the holder of the PC if there were claims that the conditions stated therein had not been complied with, before any action is taken to cancel the PC. The SCIT had correctly ruled that the word "shall" in S9 of the PIA indicates that it is a mandatory provision (a position supported by "ample authorities" highlighted by Counsel for the taxpayer).
2. Therefore, MITI has a legal duty under S9 of the PIA to issue a show cause letter to the holder of the PC as to why the PC should not be cancelled (on being informed by IRBM that the taxpayer had breached a condition in the PC.) As the consequence of non-compliance with the conditions of the PC is very serious (cancellation of PC/ revocation of pioneer status) the authority concerned must see that the company which would be adversely affected by any such decision must be given the chance to make its representation as to why the prescribed penalty should not be meted out. If the benefits of pioneer status are to be taken away, the taxpayer must be given "the right to be heard".
3. The process mandated by S9(1) of the PIA accords "crucial protection" under the law to the taxpayer. Hence, justice would demand that there be strict compliance with the said procedure. As the taxpayer's PC had not been cancelled under S9(1) of the PIA, the taxpayer had rightfully claimed for tax incentive, as was done in this case.
4. The taxpayer was denied what it was entitled to by the appellant without complying with the procedure set by the PIA. Therefore, the action by the appellant is null and void "*as there existed procedural violations of the mandatory provision of the law which could not be cured*."

In view of the above, the SCIT had rightly held that MITI's letter dated 17.7.2009 is fatally flawed and of no effect.

Issue 3 *– Breach of Natural Justice*

1. From the facts found by the SCIT, there was no doubt that the taxpayer was not given the opportunity to present its case to MITI on a crucial matter affecting its right to a tax incentive, and it is also not disputed that MITI took unilateral action against the taxpayer without compliance with the mandatory requirement of S9 of the PIA. The taxpayer was also left out entirely in all the communications between the IRBM and MITI.

2. There is no doubt that the taxpayer had been prejudiced by the conduct of the appellant as well MITI. The taxpayer had *legitimate expectation* that it is entitled to enjoy tax relief for the whole term granted to it and if the benefit was to be taken away, the taxpayer must be given the right to be heard. In this case, the taxpayer was deprived of its right to tax relief without first being given the right to be heard. This denial of the taxpayer's rights had resulted in the taxpayer suffering from grave economic loss.

Thus, the Court agreed with the SCIT that such act cannot stand as the very basic principle of natural justice had been infringed by the appellant and MITI.

Issue 4 *– No Breach of Pioneer Certificate*

1. No steps were taken by MITI to cancel the PC and/or revoke the tax incentives under the set procedure provided by the PIA. Instead, it resorted to a procedure which is flawed as found by the SCIT.
2. The appellant submitted that it raised additional assessment on the taxpayer as it was of the view that the taxpayer had breached condition (j) of the PC, as it did not exclusively export the products, but part of the export was done by its holding company.

The SCIT had the benefit of hearing the witnesses before it and has stated in clear words, the

facts as found by it under the heading "Proved Facts". Upon scrutinizing the facts found by the SCIT, the Court could not find any reason to interfere with the decision of the SCIT or the facts found as the appellant had not shown any circumstance which merits intervention.

Issue 5 – *The Appellant is not the Rightful Authority* (to decide on whether indirect export amounts to non-compliance of the PC).

1. This is also a fact found by the SCIT, who also found that the authority lies with MITI pursuant to S9 of the PIA.
2. From the letter written to MITI by the appellant, the Court deduced that "*the appellant had written the letter in such a manner so as to elicit and prompt a prejudicial response from MITI*…." (Among the circumstances that led to that deduction was the failure on the appellant's part – to give "the right to be heard" to the taxpayer; to fully apprise MITI of all the facts of the case; to keep the taxpayer informed of communications between the IRBM and MITI; to seek clarification from the taxpayer which is the party affected by any adverse decision by the appellant or MITI.)
3. From the above, it was obvious that the appellant had exceeded the authority granted by the ITA and had encroached into the jurisdiction of MITI.

Therefore, the appellant had acted *ultra vires* in disallowing the taxpayer's claim for tax incentives under the PC and the SCIT's decision as stated under issue 2 above is correct.

Issue 6 – *Time bar (whether the appellant can invoke S91 of ITA)*

1. The additional assessment raised on the taxpayer for YA 2000(CY) was made beyond the time frame (6 years) provided under S91(3), except where the appellant can prove the existence of fraud, wilful default or negligence on the part of the taxpayer.
2. The appellant contended that the taxpayer was negligent in preparing its accounts for YA 2000(Preceding Year Basis) by having more than 12 months in the basis period, and by so doing, had caused a loss of revenue to the Government of Malaysia since the income for the additional months is also waived (YA 2000(PY) being a "waiver year" for purpose of income tax).
3. However, the Court reasoned that the effect of pioneer status (effective from 1.10.1992 to 30.9.2002) is similar to that of a waiver year, i.e. income from the pioneer business during the period covered is exempt from tax. The waiver year (1999) is part of the taxpayer's pioneer status period (a fact found by the SCIT). Therefore regardless of whether there was a waiver year or not, the taxpayer's income is still exempted from tax during that period.

Based on the above, the appellant's contention of negligence on the taxpayer's part cannot be supported, has no merits and is rejected by the Court. The appellant cannot rely on S91(1) to justify the additional assessment raised on the taxpayer.

Issue 7 – *Whether the appellant can impose penalty of 45%*

Based on the reasons stated above, the appellant lacked the legal grounds and authority to raise the additional assessment in the first place. Hence, it has no grounds to impose the penalty.

Members may read the full Grounds of Judgment at the Institute's website and the LHDNM website.