CHARTERED TAX INSTITUTE OF MALAYSIA

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**CHARTERED TAX INSTITUTE OF MALAYSIA (225750-T)**

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**TO ALL MEMBERS**

**TECHNICAL**

## Direct Taxation

## TAX CASE UPDATE

## Taxation of income of a property and housing developer prior to Public Ruling 3/2006

**PASDEC CORPORATION SDN BHD. v. KPHDN**

High Court of Malaya at Kuala Lumpur
Case Stated No: 14-7-07/2014
Date of Grounds of Judgment: 15 March 2016
Date of Decision: 3 June 2015

### Facts and Issues:

The appellant is a company incorporated in Malaysia and carrying on the business of housing and property development with minor involvement in share investment. From the commencement of its business in 1980 to the year 2006, the appellant's accounts in respect of the property/housing development business were based on the defect liability period (DLP method) and income from property development projects was recognized based on the DLP method. Under the DLP method, the income or profit would be fully recognized only after the expiry of the DLP of a particular development project and the date of completion of the project would be the date of the expiry of the DLP of that project. The appellant's stand on the use of the DLP method was that it was in accordance with industry practice and with generally accepted accounting standards in Malaysia.

In 2006, the Inland Revenue Board (IRBM) issued Public Ruling (PR) 3/2006 – Property Development & Construction Contracts, which took effect from the year of assessment (YA) 2006, and this PR was duly followed by the appellant from YA 2006. Prior to the issue of PR 3/2006, there was no law or guideline by the IRBM that prescribed the use of the Certificate of Fitness (CF) method in the property development industry.

For the 3 years of assessment 1999, 2000 (current year basis) and 2002 (the years under appeal), the appellant had computed its accounts for income tax purposes based on the DLP method of income recognition. The appellant's tax computations for these years were duly accepted by the IRBM and assessments were duly issued. However, the IRBM conducted 2 tax audits on the appellant's accounts (in June 2005 and in April 2006) as a result of which the IRBM reversed its position of accepting the DLP method of income recognition and took the view that the DLP method was not acceptable for income tax purposes. Following this, the IRBM issued revised assessments for YA 1999, YA 2000 (current year basis) and YA 2002 and imposed penalties for these years as follows:

| No. | YA | Additional tax (RM) | Penalty (RM) |
|---|---|---|---|
| 1. | 1999 | 332,900.17 | 126,178.41 |
| 2. | 2000 (current year basis) | 168,160.30 | 1,294.02 |
| 3. | 2002 | 681,174.45 | 165,813.73 |

The taxpayer appealed to the Special Commissioners of Income Tax (SCIT) against the above assessments. The issues for the SCIT's determination were:

1. YA 1999 – whether the respondent is entitled to raise an additional assessment on the appellant on 30.8.2007 without first complying with S91(3) of the Income Tax Act 1967 (ITA);
2. All years under appeal – whether the respondent is right in law to adopt a different accounting basis in ascertaining the profit of the appellant when the accounting practice adopted by the appellant is one which:
   - is in accordance with industry practice and generally accepted accounting standards;
   - has been consistently followed;
   - is not inconsistent or against any written law; and
   - has in fact been accepted by the respondent up to 2006.

The appellant also appealed against the imposition of penalties for the relevant years of assessment under S113(2) of the ITA. (All provisions cited hereafter refer to sections of the ITA.)

The SCIT dismissed the appellant's appeal on both counts. Among the findings of the SCIT were the following:

- The method of profit determination adopted by the respondent which is based on CF, for the years under appeal, is "more reasonable and justifiable" and therefore the respondent is right in adopting a different accounting method.
- The method adopted by the appellant amounted to deferment of income reporting and is not in compliance with S24(1)(a) which states that income from the business must be taxed in the same year that it is earned.
- The provisions of the ITA must be strictly applied in the computation of gains or profits of a chargeable person under the ITA;
- Even though the method adopted by the appellant is not inconsistent with the provisions of the ITA, the respondent has the discretion to improve or replace it with any other method which is more suitable.

The appellant appealed to the High Court against the decision of the SCIT.

**Decision:**

Appeal allowed. As PR 3/2006 came into existence only on 13 March 2006, it was unreasonable for the respondent to impose that PR on the appellant retrospectively so as to affect all assessments made before its coming into force, which had become final and conclusive pursuant to S97(1). The respondent was also wrong in imposing penalties under S113(2) as the appellant was not shown to have submitted incorrect information and/ or incorrect returns, and it had made full disclosures pertaining to the method of computation in recognizing income, it being a matter of interpretation or difference of opinion on which method to adopt.

The grounds of decision are summarized below:

*Issue 1*

1. The (additional) assessment for YA 1999 was raised out of the statutory time frame provided in the ITA, on the basis that there was negligence on the part of the appellant in declaring its income. The applicable provision is S91(3) which allows the respondent to make an assessment in respect of a "statute bar*(red)*" claim for loss of tax attributable to "fraud, wilful default or negligence".
2. The burden is on the respondent to show on the balance of probabilities, that the appellant had intentionally submitted the tax return or furnished information which the appellant knew to be false or did not believe in their truth, or recklessly not caring whether they be true or false. (*Chong Woo Yit vs. Gov. of Malaysia [1989] 1 MLJ 473*)
3. The Court took note of the following facts (among others) which are "undisputed" –
   - From 1980 to 2006, the appellant had prepared its accounts "year after year", based on

the DLP method, before the advent of PR 3/2006 and the respondent had duly recognized and accepted the appellant's tax computations for these years, and never complained that the DLP method contravened the provisions of the ITA.

- The DLP method of income recognition was in accordance with industry practice as well as generally accepted accounting standards (proved by evidence of the witness called by the appellant.)

4. The appellant had submitted the tax return for YA 1999 to the respondent (together with a copy of the audited accounts) which the latter had duly examined, and (after making the necessary adjustments) had issued the assessment notice which was attached to the letter (from the respondent) dated 24 September 1999. The appellant had acted upon what was submitted and duly paid its taxes for YA 1999 to the respondent.
5. From the Proved Facts in the Case Stated, it would appear that there has been no suppression of information on the part of the appellant and/or evidence of fraud, wilful default or negligence. Based on the Proved Facts, the Court is satisfied that the respondent had failed to discharge the burden (imposed under S91(3)) to prove that the appellant had been negligent in submitting its tax return based on the DLP method.
6. In view of the above, the assessment for YA 1999 would be final and conclusive, pursuant to S97 of the ITA.
7. The Court is also of the view that "the DLP method has merits as well as being accepted in the property and housing development industry" (for reasons which are listed in paragraph 29.1 to 29.4 of the Judgment).
8. As there is no justification for the respondent to impute negligence to the appellants, (as stated above) it is not opened to the respondents to rely on S91 to extend the time within which it could impose additional tax on the appellant as the respondent is bound by limitation.
9. Since the additional taxes imposed for YA 1999 are barred by virtue of S91, likewise the penalty imposed too was wrong in law and unjustified.

*Issue 2*

1. It is the Court's finding that what matters here was "*whether the method of calculation was accepted that it was in accordance with the standard practice of commercial accounting in relation to the property and housing development industry*." This was supported by the evidence of the professional accountant who prepared the tax returns of the appellant, which was uncontroverted by evidence adduced by the appellant and further supported by way of case stated that the DPL method had been adopted and accepted by the respondent.
2. Since no evidence was found by the SCIT to counter the evidence of the above mentioned witness, it remains a fact that the DLP method was an accepted accounting method which was in accord with standard practice of commercial accounting involving property and housing development, which was accepted "*without any query by the respondent for 26 years*."
3. The SCIT had cited case laws (refer to paragraph 42 of the Judgment) wherein it was held that the general scheme of the Act is that income tax is charged on the income earned in the relevant basis year. Hence (the SCIT held) that a housing developer must be taxed just like any other trader and for purposes of gross income for a basis period the sales of units, work in progress and stock-in-trade must be taken into account.
4. Despite the above, it was not disputed that at the material time, PR 3/12006 was not yet in force and there was no other guideline and/or law that provides guidance/rules for determination of income earned by housing developers for income tax purposes. As such any acceptable accounting method could be used for ascertaining income of a taxpayer.
5. As there are 2 accounting methods which could be used, the appellant ought not to be faulted

if it had opted for the DLP method, more so when there was no stipulated method in the ITA, nor any guidelines relating to this. It was unreasonable for the respondent to impose PR 3/2006 (which came into existence only on 13 March 2006) retrospectively on the appellant.

6. The appellant was not shown to have submitted incorrect information and/or incorrect returns, had made full disclosures pertaining to the method of income recognition, and it was a matter of difference of opinion as to which method is to be adopted. Even assuming that incorrect returns/ information was submitted, it was submitted in good faith whereby full disclosures were made to the respondent. Hence S113(2) ought not to be applied to the appellant.

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