
TECHNICAL

Direct Taxation**TAX CASE UPDATE**

Whether “incentive payment” to employees is “bonus” under [S39\(1\)\(h\)](#) of the ITA

[KPHDN v LUXABUILT SDN. BHD.](#)

High Court of Malaya at Kuala Lumpur

Civil Appeal No: R2-14-08-08

Date of Judgment: 17 May 2010

Facts and Issues:

This is an appeal by the Appellant (Director General of Inland Revenue) against the decision of the Special Commissioners of Income Tax (SCIT) who held that “incentive payment” of RM745,480 paid to employees of the respondent/ taxpayer company (“the taxpayer”) for the year of assessment (YA) 2000 was not “bonus” referred to in [S39\(1\)\(h\)](#) of the Income Tax Act 1967 (ITA) and hence, allowable under [S33\(1\)](#) of the ITA. (All sections cited hereafter are sections from the ITA unless otherwise stated.)

The following are the facts that were proved or admitted before the SCIT:

- The taxpayer is a private limited company incorporated in 1985 and carrying on the business of interior design fit outs and renovations for commercial buildings and offices.
- As a result of a field audit of the taxpayer’s accounts, the taxpayer was issued with a Notice of Additional Assessment for YA 2000 dated 25.9.2004 (the subject of the appeal to the SCIT).
- Incentive payments made are separate and distinct from bonus payments and in fact represent remuneration for extra work and services.
- Payment of the above was part of the business strategy of the taxpayer, and has been consistently and genuinely applied even before the re-introduction of bonus restriction in 1998.
- The taxpayer pays “*salary, bonus and incentives*” to its employees. Salary is a basic and obligatory payment under the employee’s contract of service. Bonus is for “*job considered well done*” and depends (amongst other factors) on profits of the company and market conditions. “*Incentive is given to employees for securing sales and collections and to promote a sales and revenue driven culture within the workforce....*”
- The incentive system was formalized at the meetings of the board of directors, as recorded in the minutes of meetings of the BOD dated 16.11.1998, 7.12.1998 and 13.12.1999.
- The need for formalization of the incentive payments was driven by the economic conditions of 1998 and did not present any shift in the consistent policy/ strategy of the taxpayer.
- Incentive payment is not bonus because it is not a payment added to what is usual. It is a payment for doing something different or something extra.

The issue for determination was whether the SCIT were correct in their decision.

Decision:

Appeal dismissed. The grounds of decision are summarized below:

1. Duty of the court

The Court considered the principles of law regarding the duty of the court when hearing appeals against decisions of commissioners in tax cases. Among the cases referred to is *Mamor Sdn Bhd v DGIR* [1981] 1 MLJ 117 wherein the learned Judge expressed “ the opinion that it is open for the High Court to review the decision of the Special Commissioners if the Special Commissioners:

- i. *misdirected themselves on the law; or*
- ii. *answer the wrong question; or*
- iii. *omit to answer a question which they ought to have answered; or*
- iv. *took into account factors which they ought not to have; or*
- v. *reached a conclusion on the facts which is not supported by the evidence before them; or*
- vi. *made a finding of facts which no reasonable person in the circumstances would have arrived at.”*

2. Submissions

By the appellant (Director General of Inland Revenue)

The appellant submitted that the so-called “incentive payments” were in actual fact bonus payments for carrying out the normal duties of the recipients and there were no extra duties and/ or jobs performed. The ordinary meaning of “bonus” (in the absence of a statutory definition) is “*a boon or gift over and above what is normally due as remuneration to the receiver...*” (citing the case of *DGIR v Highland Malaya Plantation Ltd* [1988] 2 MLJ 99). In the present case, the SCIT’s finding that the payment was made for extra work done was unsupported by facts and the SCIT had failed to explain what were the extra duties and/ or works performed by the taxpayer’s staff.

By the respondent (taxpayer)

The crux of the respondent’s (taxpayer’s) argument is that the incentive payments cannot be regarded as bonus, and are fully deductible under [S33\(1\)](#). Going by the definition of bonus as “a boon or gift...” (quoted above), payment for additional work cannot be seen as bonus. The SCIT had come to the factual conclusion that the incentive payments were for extra work and services and therefore not a bonus, which was based on the relevant evidence adduced and there is no requirement to cite the evidence in the Case Stated. The SCIT had clearly stated their rightful finding of facts, and it cannot be said that no reasonable person in the circumstances would have arrived at the conclusions made by the SCIT.

3. Findings of the Court

- The Court agreed with the submission of the taxpayer, that in the circumstances of the case, the incentive payments cannot be regarded as bonus and are fully deductible under [S33\(1\)](#). It went on to consider the principles applied in defining “bonus” in the following cases (with principles and relevant comments shown below):
 - i. *DGIR v Highland Malaya Plantation Ltd (supra)*

"It must be noted that it (bonus) was not paid for any extra work done or services rendered by the managerial staff beyond the call of the standard letters of appointment."

The SCIT have correctly applied the principle stated in the above-cited case and the incentive payments are not "a boon or gift over and above what is normally due as remuneration to the receiver".

ii. *DGIR v Harrison's & Crosfield (M) Sdn Bhd* [1988] 2 MLJ 223

"...the 'additional remuneration' given to the managerial staff....was also paid for doing their normal duties and not for doing any specific extra job or specific extra services rendered beyond the call of their standard 'letter of appointment'."

"...To determine whether a payment is a bonus, we have to go behind the label and seek its true character.."

The decision of the SCIT is consistent with the judgment in the above case.

- "Incentive" ordinarily means "serving to encourage, rouse, or move to action....designed to enhance or improve production" (Webster's Third New Dictionary 1141 (1981)). The taxpayer paid "incentive payments" to employees for securing sales and collections and to promote a sales and revenue driven culture within the workforce irrespective of their actual duties. This policy was formalized by the meetings of the BOD. It is not difficult to see this business strategy as "incentive" in that it rewards staffs who have performed duties over and above what is required of them.
- In arriving at their conclusion the SCIT had full recourse to all relevant documents and information (details listed). The history of all resolutions on the incentive payments is shown in the Statement of Agreed Facts. Therefore there are no gaps in the case and the SCIT cannot be said to have reached a conclusion on the facts which is not supported by the evidence before them, or made a finding of facts which no reasonable person in the circumstances would have arrived at.
- There was sufficient evidence (oral and documentary) before the SCIT in deciding that the recipients had performed duties over and above what is required of them and they expected payment for the same.

Having given consideration to all the above, the Court was of the considered opinion that no appellate intervention was warranted in this appeal.

Members may read the full Grounds of Judgment at the [Institute's website](#) and the [LHDNM website](#).

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