

TECHNICAL

Direct Taxation

TAX CASE UPDATE

Determination of date of change from partnership to sole proprietorship.

YUNAINAH BINTI IDRUS v KPHDN

High Court of Malaya at Kuala Lumpur

Tax Appeal No: 14-5-10/2015

Date of Judgment: 1 August 2016

Facts and Issues:

This is an appeal against the decision of the Special Commissioners of Income Tax (SCIT) who dismissed the appellant's appeal against assessments raised on her via notices of assessment for the years of assessment (YA) 2005 and 2006 dated 25.1.2010. The SCIT held that the appellant's income for the said YA was not from a partnership but from a sole proprietorship.

The appellant was one of 2 partners who signed a Partnership Agreement (PA) dated 15.10.2003 for the operation of a petrol station under the name "Fill In Enterprise". A Supplemental Agreement (SPA) was signed on 10.5.2004. The Inland Revenue Board of Malaysia (IRBM) conducted a tax audit of the accounts of the business of the appellant for YA 2004 to YA 2007 on 19.6.2009. As a result of the audit, the appellant was issued with the notices of assessment mentioned above. The appellant was assessed for these years on income derived from a sole proprietorship and not from a partnership. The appellant appealed against the assessments, contending that the income for these years should be assessed as income from a partnership in accordance with clause 3.4 of the SPA, which stated that the appellant (P1) and her partner (P2) had agreed to share the net profits of each year in the ratio 60:40.

The SCIT dismissed the appeal, and the appellant then appealed to the High Court.

Decision:

Appeal dismissed. The grounds of the decision are summarized below:

1. Among the terms of the PA and the SPA that were highlighted by the Judge were the following:
 - (a) Under the PA, the terms relating to:
 - responsibilities of each partner (P1 and P2);
 - share of capital and profit sharing
 - Total capital of RM350,000 contributed by P1 (RM210,000 [60%]) and P2 (RM140,000 [40%])
 - Any profits/ losses to be shared and distributed to P1 and P2 in the ration 60:40.
 - (b) Under the SPA, the terms relating to the following:
 - withdrawal from the Partnership (Clause 2) – spelled out the agreement for P1 to purchase from P2, the latter's share of the partnership (40%) for a purchase price of RM240,000, to be paid as follows:
 - A sum of RM20,000 to be paid upon signing of the SPA, as part payment of a

- deposit of RM40,000, and the balance by 4 instalments of RM5,000 each as mutually agreed by the Partners, but to be settled in full on or before 31.12.2006.
- The balance amount of the purchase price of RM200,000 to be paid to P2 on or before 31.12. 2006.
 - Entitlement of the partners (Clause 3) – set out the entitlement of each partner as to benefits (allowances and accommodation), share of interest from fixed deposit, and share of net profits.
 - Completion date (Clause 6)
 - The completion date of the purchase of the 40% share of the partnership by P1 was to be 31.12.2006;
 - However, provision was made for other terms to become applicable in the event that P1 desired to settle all payments before the completion date, or in the event that the balance of the purchase price was not paid by P1 on (by) 31.12.2006.
2. Based on Clause 6 of the SPA, the appellant contended that the partnership between P1 and P2 still existed until 31.12.2006.
 3. However, the respondent contended that the partnership had ceased on 22.5.2004, the date on which the change of status of the business from a partnership to a sole-proprietorship was approved by the Companies Commission of Malaysia (CCM).
 4. Therefore the question that had to be answered by the High Court (the Court) was “When did the partnership end?”
 5. In the Judge’s view, the partnership had ended on 22.5.2004, the date on which the CCM granted approval for the appellant’s application (which was submitted by the appellant after signing the SPA) to change the business from a partnership to a sole-proprietorship.
 6. Based on the facts and documents submitted, the Judge questioned that if it was true that the appellant had regarded the partnership as continuing to exist until 31.12.2006, why did she change the status of the business to a sole proprietorship barely 2 weeks after signing the SPA. Why was that change of status not done after 31.12.2006, or at least after 5.12.2005 (the date on which full payment was made to P2)?
 7. It was also pointed out that the appellant had signed on the Form B2 in her capacity as the sole proprietor of Fill In Enterprise.
 8. The SPA only made clear the appellant’s agreement to purchase P2’s 40% share of the partnership. The way by which the payment was made (staggered over a period) as spelt out in the SPA, was only a “mode of payment”. What was important was that the intention to dissolve the partnership was accomplished when the SPA was sealed.
 9. In conclusion, based on the documentary evidence submitted, it was clear that the partnership between P1 and P2 had ended when the SPA was signed on 10.5.2004 (see Note below). This was confirmed by the change of status of the business from a partnership to a sole proprietorship which was approved by the CCM on 22.5.2004.

Note: There appears to be a typo in paragraph 29 of the Judgment which states the date as 10.5.2005.

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

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