

TECHNICAL

Direct Taxation

TAX CASE UPDATE

Claim for Reinvestment Allowance and Penalty Imposed Under Section 113(2), ITA

Ketua Pengarah Hasil Dalam Negeri v Firkos (Malaysia) Sdn Bhd (2013) [High Court]
(Civil Appeal No: R2-14-9-09/2012)

Facts:

Firkos (Malaysia) Bhd (the Respondent) had claimed reinvestment allowance (RA) for the years of assessment 2005 and 2007 in respect of expenditure on the following items ("the Disputed items"):

- i) Plant and machinery (Fire-fighting equipment and electrical fittings)
- ii) Factory
- iii) Cost of site preparation for installation of plant in the factory

The Director General of Inland Revenue (the Appellant) disallowed the claim in respect of the following:

- i) The whole capital expenditure on fire-fighting equipment and 72.7% of expenditure on electrical fittings (on the basis that 72.7% of the factory is warehouse space)
- ii) 72.7% of factory (warehouse space)
- iii) The whole capital expenditure on site preparation for installation of plant

The Appellant had informed the Respondent that the "production area" which qualified for RA was 27.3 % (corresponding to the percentage of capital expenditure allowed on electrical fittings and factory). The claim for RA for fire-fighting equipment was disregarded, while expenditure on site preparation for installation of plant (the Respondent was informed) is not eligible for RA under Schedule 7A of the Income Tax Act 1967 (ITA). Consequently, the Appellant raised additional assessments for the years of assessment 2005 and 2007 with penalties imposed under Section 113(2) ITA.

The Respondent then appealed to the Special Commissioners of Income Tax (SCIT), who allowed the Respondent's claim in relation to the Disputed items and held that penalty imposed for the year of assessment 2007 was not appropriate ("tidak wajar"). The Appellant appeals to the High Court.

Issues:

- i) Whether the Disputed items qualified for RA under ITA, as claimed by the Respondent for the years of assessment 2005 and 2007.
- ii) Whether the Appellant exercised its discretion properly and lawfully in imposing penalty under Section 113(2) of the ITA in the year of assessment 2007.

Decision:

It was held, by Dato' Zaleha Binti Yusof J, that:

- The principle enunciated in *Ketua Pengarah Hasil Dalam Negeri v Success Electronics and Transformer Manufacturer Sdn Bhd* (Rayuan Sivil No. R1-14-14-09) is applicable. The functionality of the Disputed items in the overall context of the Respondent's manufacturing activity ought to be taken as a valid factor in considering the Respondent's RA claim:
 - the warehouse areas are essential and inherent in the nature of the Respondent's business.
 - the installation of fire-fighting equipment was necessary for the construction of the factory.
 - site preparation for plant installation was also vital and formed integral and incidental part of the Respondent's manufacturing activity, without which its activity would not be able to function adequately.
- The words "existing business" before the words "in respect of manufacturing or processing a product" in para 8(a) of Schedule 7A of the ITA must be read together as a whole, so that the expression "*existing business in respect of manufacturing or processing of a product*" is the more probable expression which is consistent with the intention of the Legislature in enacting para.8(a) of Schedule 7A". The submission of the Appellant that the eligibility of capital expenditure for RA shall be subject to whether that part of the building or whether the plant or machinery is involved in the manufacturing process/activity, or transforming raw materials into an end product is rejected.

By imposing the condition of "production area" to the meaning of 'manufacturing', "*the appellant had clearly acted ultra vires, illegally and without jurisdiction.... The Appellant cannot be allowed to usurp the role of Parliament by coining its own definition of "manufacturing" and drafting its own law.*"
- Section 113(2) confers discretion on the Appellant as to whether penalty should be imposed or not. The matter in dispute arose as a result of technical adjustment, i.e. due to a differing interpretation of the tax legislation by the respondent and the respondent had acted in good faith and made full disclosure. The SCIT's decision relating to Issue (ii) is correct.
- There is nothing in the Appellant's submission to suggest that the SCIT had erred in their decision. Hence, appeal dismissed. Deciding Order of SCIT affirmed.

Members may read the full [Grounds of Judgment](#) from the Kuala Lumpur Law Courts Official website.

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