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e-CTIM TECH 67/2014 **3 October 2014**

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TECHNICAL

Direct Taxation

TAX CASE UPDATE

Validity of additional assessments issued under Section 91(1) and the appropriate method of computation to be adopted

Ketua Pengarah Hasil Dalam Negeri (KPHDN) v Debir Desa Development Sdn Bhd (HC 2011) (Civil Appeal No: R1-14-20-07)

Date of Judgment: 8 Oct 2011

Facts

This is an appeal by the KPHDN (Appellant) against the decision of the Special Commissioners of Income Tax (SCIT) who had allowed the appeal by the taxpayer (Respondent) against additional assessments raised by the Appellant in respect of years of assessment (YA) 1996, 1997, 1998, and 1999.

The taxpayer is a company incorporated under the Companies Act 1965 and holds a housing developer's licence. The taxpayer had acquired 2 contiguous pieces of land in Kuala Lumpur (the "said Lands") for the purpose of carrying out a mixed development project comprising of residential and commercial building units (the "Project"). In its implementation of the Project, the taxpayer undertook the following processes:

- Applied for planning approval for the Project by submitting a single layout plan to DBKL. The plan was approved by DBKL.
- Upon approval by DBKL, the taxpayer submitted a single application to the Pentadbir Tanah Wilayah Persekutuan KL (the "Land Office") for approval of conversion of the conditions in the titles and subdivision of the said Lands. Following that approval, a premium of RM1,077,260 was paid for the entire Project. Other approvals were also obtained and statutory contributions were made.
- Obtained approvals from the relevant authorities for the Project's infrastructure works such as earthworks, road, drains etc. Single applications and approvals were obtained in respect of each infrastructure. Earthworks for the Project started in 1995.

For income tax purposes, the taxpayer computed profits using the progressive payment formula for estimating annual profits in accordance with Revenue's guidelines. The formula is as follows:

$$\text{Estimated Gross Profit} = \frac{\text{Payment Received \& Receivable}}{\text{Total Value of Development of Project}} \times \text{Estimated Gross Profit for the Project}$$

The taxpayer's computation of chargeable income based on the above formula for YA 1996 to YA 2000 was accepted by Revenue and assessments were issued. Tax was paid accordingly.

However, in a letter dated 16.10. 2002, Revenue proposed to the taxpayer to use the final actual realized sales and profit figures in the progress payment formula (instead of estimated profits) and apply it retrospectively from 1995 to 1999 ("Spreading Back Proposal"). An additional assessment dated 9.10.2002 for YA 1996 was issued based on the Spreading Back Proposal. The taxpayer

did not agree to the Spreading Back Proposal. The additional assessment was paid under protest.

In Jan 2003, Revenue made another proposal to treat the Project as 3 projects, namely the shop office, the shopping mall/plaza, and the condominium, on the grounds that the commencement date for the construction of the shop office and the condominium were different and that the site for the mall/plaza was sold in 1999 before the commencement of construction of the buildings. Subsequently (on 23.8.2004), the Revenue issued additional assessments for YA 1997, 1998 and 1999 based on the 3 projects proposal.

The taxpayer duly filed the Form Q to the SCIT to appeal against the additional assessments for the years of assessment 1996, 1997, 1998 and 1999.

Issues

The issues for the determination of the SCIT are: (i) whether in the circumstances of the case, the additional assessments for the relevant years were correct and validly made on the taxpayer, and (ii) in the event that the said assessments were incorrect, what method of computation should be adopted by the taxpayer in ascertaining its adjusted income for the relevant YA. The SCIT allowed the taxpayer's appeal and ordered that the additional assessments for the relevant years be set aside.

Revenue then appealed to the High Court (hereafter referred to as "the Court") against the SCIT's decision.

Decision:

Appeal dismissed with costs.

The following is a summary of the Grounds of Judgment:

1. The Court reiterated the principles enunciated in *Edwards v Bairstow and Harrison* [1956] AC 14 (House of Lords) and approved by the Supreme Court in the case of *Lower Perak Co-operative Housing Society Bhd v Ketua Pengarah Hasil Dalam Negeri* [1994] 2 MLJ 713, pertaining to the duty of the Court when hearing appeals from the SCIT:

   > "*When the case comes before the court it is its duty to examine the determination having regard to its knowledge of the relevant law. If the case contains anything ex facie which is bad law….it is, obviously erroneous in point of law. But without any such misconception appearing ex facie, it may be that the facts found are such that no person acting judicially and properly instructed as to the relevant law could have come to the determination under appeal. In those circumstances, too, the court must intervene…*"

2. The Court took note of the findings of the SCIT as stated in the Case. The core of the appeal is whether the Respondent was carrying out 3 projects/ phases or just one. Revenue's contention that the Project consisted of 3 separate phases (namely, Phase A (shop offices); Phase B (shopping mall); Phase C (condominium)) was premised on the following:
   - Progress payments for each phase were received on different dates;
   - Different entries of development properties and expenditure in the audited accounts (e.g. for the financial year ending 31.12.1999, separate entries were made for "building work" done for the shop offices and for the condominium.);
   - Different commencement dates for the shop offices and for the condominium;
   - A proposal for the development of the shopping mall was separately made for DBKL approval on 14.7.1998.

   It was noted that these same arguments which were "regurgitated" in the appeal before the

Court, have been duly noted by the SCIT.

3. Revenue cited the case of Sarawak Properties Sdn. Bhd. v The DGIR [1974] 4 AMR 3181 as being "on all fours with the instant case" in support of the points made in (2) above. However, the Court was of the view that the instant Case can be distinguished from the case cited, and adopted the Respondent's list of distinguishing features, including the facts that the Respondent had only one Development Expenditure (DE) Account, and was the single owner for the Project (while Sarawak Properties had 2 DE accounts and there were 2 different owners for the 2 respective projects, there was no relation in terms of authority, approvals, statutory contributions, etc. between the 2 projects).

4. Revenue further submitted that recent developments show that whether a project is one or many, a vital criterion is what development units were involved and whether there is a cost accumulating centre and not whether the projects have a single layout plan or whether there is a single application for approvals from authorities as was the approach taken by the SCIT.

   Revenue contended that the SCIT did not find that there is one cost accumulating centre or that the company accounts treated the entire development as one project. Citing the following for support –

   i. Regulation 3 of the Income Tax (Property Development) Regulations 2007 (PDReg);
   ii. Paragraph 3 of the Public Ruling No. 1/2009 (PR No. 1/2009),

   However, it was pointed out by the Court that both the PDReg and the PR No. 1/2009 were not submitted before the SCIT and the PDReg are deemed to have effect from YA 2006 and subsequent YAs, while the date of issue of the PR No. 1/2009 was 22.5.2009 and is effective for YA 2006 and subsequent YAs. Hence, the PDReg/ PR No. 1/2009 cited above are not applicable to the appeal at hand.

   What is applicable is the PR No. 3/2006 dated 13.3.2006 (now replaced by the PR No. 1/2009) which defines "Project" as "a cluster of development units within a designated geographical area forming a cost accumulating centre including vacant lots for development".

   (*Note: In the PR No. 1/2009, the definition of "Project" has the added phrase "and where a cluster of development unit is erected in more than one phase, the development units erected in each phase shall be treated as a separate cluster of development units erected within a designated geographical area".)*

5. The SCIT had also noted that the witnesses for the Respondent had testified to the following –
   - Different phases do not equate to different projects;
   - Earnest deposit is not a cost accumulating centre;
   - The taxpayer had only one cost accumulating centre.

   All the above facts were not challenged by Revenue. The irresistible inference from the above observations is that the SCIT had made a finding of fact that the Project consisted only of one project and not 3 projects. The Court agreed with the Respondent's submission that such a finding of fact is unassailable since it has been substantiated by evidence and there is no misdirection in law. (Ref. KPHDN v. Aneka Jasaramai Ekspress Sdn Bhd [2005] MSTC 4095)

6. The Court agreed with the Respondent's submission that the SCIT's finding is the additional assessment for YA 1997 was statute barred because it was not made within 6 years as required under S91(1) of the ITA. Although Revenue invoked S91(3) of the ITA (fraud, wilful default or negligence on the part of the taxpayer), the SCIT's finding was that Revenue only appeared to rely on negligence but had failed to prove negligence on the part of the Respondent.

Based on the above grounds, the Court found that there was no misdirection in law in the finding of the SCIT, neither was there any justification to reverse the finding of the SCIT.

Members may read the full Grounds of Judgment from the Kuala Lumpur Law Courts Official website.