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TAX CASE UPDATE

Exemption from income tax for “a non-profit oriented school” under Exemption (No. 5) Order 2008

[Syarikat Pendidikan Staffield Berhad v Ketua Pengarah Hasil Dalam Negeri \(KPHDN\) \(HC\) 2011 \[Permohonan Semakan Kehakim No. R2\(3\)-25-10-09\]](#)

Date of Judgment: 11 January 2011

Facts

The Applicant, Syarikat Pendidikan Staffield Bhd (SPSB) was incorporated on 8.7.1998 as a company limited by guarantee without shareholders under the Companies Act 1965 (CA). Its Memorandum of Association, states that:

- i. The company's one and only objective is “the establishment and maintenance of a residential school or schools or other education establishments....for the promotion, propagation and encouragement of education....”
- ii. The income and property of the company is to be “apportioned solely toward the promotion of the objects of the Company, as set forth in Memorandum of Association; and no portion thereof shall be paid or transferredby way of dividend, bonds or otherwise to the members of the Company....”

SPSB is engaged solely in the establishment and operation of Tuanku Ja'afar Kolej in Negeri Sembilan, which commenced operations on 6.1.1991. It provides secondary school education under 2 parallel streams – i.e. “the KBSM Malaysian stream” which follows the Malaysian Government syllabus, and the “international stream” for students working towards Cambridge and London ‘O’ levels or International GCS examinations. The College is recognized by and is registered with the Ministry of Education, Malaysia.

The Budget Speech for Budget 2008 (presented in September 2007) contained the statement that the government recognized “...schoolsfunded and well managed by charitable bodies.” and a proposal to grant income tax exemption to such schools. “The exemption will benefit particularly Chinese and Tamil Schools as well as religious schools.” This was followed by the issuance of the *Income Tax (Exemption)(No.5) Order 2008 [P.U.(A) 247/2008]* on 10.6.2008, (gazetted on 14 July 2008) which took effect from the year of assessment (YA) 2008.

By a letter dated 17.10.2008, SPSB (through its tax consultant) sought confirmation from KPHDN that it was entitled to exemption under the Order. The reply was given in a letter dated 5.12.2008, which declared that SPSB did not qualify for exemption under the said Order.

Being dissatisfied with the Respondent's decision, the Applicant made an application for judicial review for the following orders:

- a) An order of certiorari to quash the Respondent's (KPHDN) decision made by letter dated 5.12.2008 that the Applicant does not qualify for exemption under Exemption (No. 5) Order 2008 (“the Order”)
- b) A declaration that the Applicant qualifies for exemption from income tax under the said

Order;

- c) An order of mandamus commanding the Respondent to give full effect to (a) and (b) above.

Issue

The sole issue for determination of the Court is whether, under the facts presented, the Applicant qualified for an exemption from taxation under the Order.

The Applicant submitted that it fulfilled all requirements for exemption because

1. It is a company limited by guarantee registered under the CA;
2. It is resident in Malaysia;
3. It functions solely for the purpose of establishing and managing a non-profit oriented school;
4. It is registered under the Education Act, 1996 and recognized by the Ministry of Education Malaysia (MOEM);
5. It is not operated for profit;
6. It is not at this stage approved under [S44\(6\)](#) of the Income Tax Act 1967.

The Respondent's main contention was that the Applicant's management of the College is profit oriented in nature, i.e. it is in the business of providing education for profit. Some facts (among others) which are cited to support this contention are:

1. SPSB does not provide education for free, nor does it charge a nominal fee;
2. It receives substantial income from tuition fees as well as income from other sources;
3. It received high profit for the financial years ended 2005, 2006, and 2007 (not the norm for non-profit oriented schools);
4. Its trustees have the discretion to declare bonus interest (to debenture holders) from its profit.

Decision

Application allowed with costs.

The following is a summary of the grounds of decision:

1. Under the law, all profits are subjected to tax unless exempted by statute. Statutes granting tax exemptions must be strictly construed in favour of taxation and courts have no power to create exemption by judicial construction.
2. The burden of establishing entitlement to exemption rests upon the person seeking it, who must prove by convincing evidence that the profit in question falls within the terms of the statute granting the exemption.
3. Under the Exemption Order, exemption from payment of income tax is granted in respect of "income received from the management of a **non-profit oriented school**" which is defined therein as a school which is –
 - a. registered under the Education Act 1996 (Act 550)
 - b. approved and recognized by the MOEM;
 - c. not operated or conducted for profit.
4. The Respondent concedes that all requirements under the Order are met by the Applicant except the requirement that the school must not be operated for profit. The nub of the Respondent's submission is that the term profit refers to **what is available by way of distribution to members or shareholders**.

5. The Respondent submitted that a purposive approach in determining the meaning of profit must be adopted, and using this approach, the Budget speech showed that the Order was meant for organizations that are charitable in nature.
6. The defining characteristics of a charitable institution include, inter alia, that it dispenses charity to all who need it and apply for it. Various facts were cited which (the Respondent contends) negated the Applicant's claim to be a charitable body. Among these was the fact that it charged a high tuition fee (RM25,000 per year), as well as various other charges (e.g. registration fee of RM300; deposit of RM20,000 and acceptance fee of RM3000). Such high fees cannot be afforded by the needy or the poor, hence it is not for the public at large, and the number of needy and poor students was non-existent.
7. The crux of the Respondent's submission seems to be that the Applicant did not provide free education for indigent students.
8. The Court disagreed with the submission of the Respondent. The Court was of the view that the term 'non-profit' was misunderstood by the Respondent who believed that "companies so classified should generate no surpluses and accumulate no reserves". Referring to the case of [Commissioner of Taxation v Word Investments Ltd \[2007\] FCAFC 171](#), the Court sets out the following observations :
 - a. "The Court...found that the proper task is an integrated and holistic enquiry to assess the true character of the entity by reference to its **objects, purposes and activities**".
 - b. "This case provides an important change from the previous view that the conduct of commercial 'non-charitable' activities will render the entity non-charitable. Rather, a charitable organization can conduct non-inherently charitable activities so long as the **clear and exclusive purpose is to raise funds to deploy in ways that are charitable.**"
 - c. "It is settled, therefore, that non-profit organizations can engage in any business enterprise in the fulfillment of their mission objective without affecting their tax-exempt status. They are free to do anything a for-profit company might do in pursuit of their goals including making profit. The real concern is **whether any portion of the profit received by the organization is permitted to inure to the benefit of any private individual engaged in managing the organization.**"(Emphasis added)
9. For this purpose, the Court adopts the reasoning of the court in [Kennemer Golf and Country Club v Staatssecretaries Van Financien](#) and [Customs and Excise Commissioner v Zoological Society of London \[2002\] QB 1252](#), from which it quoted the following:

"an organization was non-profit-making if it did not have the aim, such as that of a commercial undertaking, of achieving profits for its members, and, provided that was so, the fact that the organization made operating surpluses, even if it sought to make them or did so systematically, did not affect that categorization, so long as the surpluses were not distributed to the organisation's members as profits."

"I agree....that the idea of profit-making...relates to the enrichment of natural or legal persons, in particular those having a financial interest in the organization in question – rather than to whether in any given period the organization's income exceeds its expenditure..."

"....the focus must be on the aims of the organization concerned rather than on its results – the mere fact that an entity does not make a profit over any given period is not enough to confer non-profit-making status...."

10. It should be emphasized that in the instant case the charitable object for which the Company is incorporated is the “establishment and maintenance in accordance with the laws of Malaysia residential school or schools or other educational establishment and encouragement of education.”
11. The Applicant has made operating surplus, but it has no shareholders to whom it can distribute profits, and its members are strictly prohibited from receiving any distribution of profit by its Memorandum and Articles which also clearly states that income and property of the Applicant are to be applied solely towards the promotion of the object of the company. Furthermore, payments to trustees are also prohibited.
12. The avowed purpose of the Order is to provide exemption for income which would otherwise be taxable. If ‘not operated for profit’ meant ‘not operated or conducted to make an operating surplus’, there would be absolutely no point in providing the exemption since persons not making an operating surplus have no exposure to income tax.

Note

*The Court rejected Revenue’s argument that since the taxpayer’s objective is to operate a business of providing education for profit (surplus of income over expenditure), it is not a “non-profit oriented school” and it cannot be a charitable institution because of its objective of making profits. The principle established in this case is that an organization with objects that meet the criteria of “charitable” objects, does not cease to be a charitable body even though it engages in activities which are profitable (produce surplus of income over expenditure), so long as the profits are applied to promote the objects of that organization. It’s “**non-profit oriented**” status refers to the prohibition from applying the profits/surplus for the “enrichment of natural or legal persons, in particular those having a financial interest in the organization in question.”*

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

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