
TECHNICAL

TAX CASE UPDATE**Income exempt from tax – whether gross income or chargeable income.**

[*KPHDN v. Perbadanan Kemajuan Ekonomi Negeri Johor*](#) (Court of Appeal) 2009

[Civil Appeal No: J-01-61-2002](#)

Date of Judgment: 10 April 2009

Facts:

The respondent (the taxpayer) is a statutory body incorporated under the Johor State Enactment No. 4 of 1968. Its principal activities are to develop land for industrial, agricultural, property, mining, logging and other corporate activities. It has two sources of income, from business and dividend.

The taxpayer is exempted from income tax under S127 of the Income Tax Act 1967 (ITA) on the following income:

<u>YA</u>	<u>Exemption</u>
1980 to 1990	All income
1991	All income except dividend income and development tax
1992 to 1996	All income except dividend income and development tax

This appeal relates to the exemptions for YA 1991 and YA 1992 only. In the tax computations for those years, the taxpayer had claimed deductions for gifts of money to the State Government from its non-exempt dividend income. The Revenue, however, apportioned the deduction between dividend (non-exempt) income and business (exempt) income and raised assessments accordingly. The taxpayer appealed against the assessments. The Special Commissioners of Income Tax (SCIT) decided in favour of the taxpayer and their decision was upheld by the High Court. Hence the present appeal to the Court of Appeal.

Issues:

The issues to be determined are –

- (i) whether “income” in S127(5) of the ITA means gross income or chargeable income;
- (ii) whether exemption of income is at the level of gross income or chargeable income;
- (iii) whether the Revenue’s apportionment formula is lawful and applicable.

(All sections referred to hereafter are references to sections in the ITA.)

Decision:

Appeal allowed. The Revenue’s apportionment formula and 2 notices of assessment were upheld.

The following is a summary of the grounds of judgment:

- *On the first 2 issues which were considered together:*
 1. S127(5) allows “income” which is exempt from tax to be “disregarded” for purposes of the ITA.
 2. Consideration of S2(2) leads to the conclusion that the “*general reference to the word*”

“income” in S2(2) is highly volatile, as the precise meaning of the word “income” is to be dictated by reference to the context and circumstances.”

3. The meaning of “income” is illuminated by S5 which sets out the various types of income, for the purpose of ascertaining chargeable income. A graphic representation of the stages in arriving at “chargeable income” from the initial “gross income” stage (attributed to an author of reputed authority on Malaysian tax law) was adopted to show that *“gross income and chargeable income are polarized. Consequently, the meaning to be attributed to the word “income” would affect the tax liability of the taxpayer.”*
4. To be “disregarded” under the ITA, an exemption from tax should legally be deducted or claimed from the chargeable income and not the gross income. This is because gross income *per se* may not be exigible to tax at all. If no tax is exigible, no question or necessity arises for claiming the exemption.

“In other words, where there is no income, there can be no liability to tax, in which case no question of exemption can ever arise. Exemption is only relevant when there is chargeable income, but not otherwise.”

5. The case of *Lower Perak Cooperative Housing Society Bhd.* in which it was held that a tax exemption is only given after liability to tax has been determined was cited in support of above conclusion.

- *On the third question –*

1. The Court accepted the Revenue’s submission which relied on the case of *Daya Leasing Sdn Bhd v KPHDN (2005) 2 CLJ 449 CA* for support of its apportionment formula. The Court of Appeal’s decision in that case was cited, wherein it *“held that the common expenses incurred had to be apportioned as implied in S33(1) and so the Revenue’s apportionment was in compliance with the law....”*
2. The above decision is arrived at after a re-examination of the facts of the *Daya Leasing* case. The following forms part of the portion from the judgment of the Court of Appeal in that case which was quoted in support of the decision:

“The power to apportion the expenses can be implied in S33(1) of the Act in view of the need to ascertain adjusted income....If S33(1) is to be strictly construed the appellant will be unable to identify the expenses separately where they are mixed with the result that the adjusted income of the sources cannot be ascertained. This will defeat the object of S33(1) and bring the machinery of tax assessment to a halt. This will not happen in the interpretation of ordinary statutes as one of the salutary canons of construction in such cases is that Parliament does not act in vain....”

3. The Court is of the view that the factual matrix in the *Daya Leasing* case bears substantial similarity to the factual background in this appeal, particularly in relation to the two unidentifiable sources of income, e.g. the non-exempt dividend income and the exempt business income in this present appeal. Applying the formula in the *Daya Leasing* case to the present case, the Court holds the view that Revenue’s apportionment of the deduction for gifts of money between the non-exempt dividend income and exempt business income is justified and lawful. It is also consistent with S5 wherein the steps in arriving at chargeable income from the initial gross income stage are set out.

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

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