

**TECHNICAL**

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**Direct Taxation**

**TAX CASE UPDATE**

**Whether payment of 25% of net profit to Consultant under an employment agreement is “bonus” under S.39(1)(h) of the Income Tax Act 1967 (ITA)**

**KPHDN v STERUDA SDN BHD**

Court of Appeal, Malaysia  
Civil Appeal No: W-01-52-04

Date of Judgment: 31 March 2009

**Facts and Issues:**

The taxpayer is a private limited company incorporated in 1975, and provides consultancy services in gynecology, obstetrics and other branches of medicine. It had entered into an agreement of employment with Dr. Ronald Steven McCoy, under which it agreed to pay Dr. McCoy RM3,000 per month plus 25% of the net profit of the clinic annually.

For the years of assessment 1978 to 1984, the taxpayer was issued with 7 notices of additional assessment on account of the disallowance of the deduction of Dr. McCoy's remuneration of 25% of net profits by the Director General of Inland Revenue (DGIR), pursuant to S.39(1)(h) of the ITA, that provides for the disallowance from deduction (in ascertaining adjusted income) of “any sum paid by way of a bonus to an employee in excess of RM1,000 or two-twelfths of his wages or salary whichever is the greater...”

The taxpayer appealed unsuccessfully to the Special Commissioners of Income Tax (SCIT) against the assessments. Before the SCIT, the taxpayer argued that the payment in question was not a bonus payment but part of the remuneration of Dr. McCoy as contracted in the employment agreement between the 2 parties, and is allowable under S.33(1) of the ITA.

The taxpayer then filed an appeal against the SCIT's decision to the High Court, which reversed the finding of the SCIT. The High Court held out the view that the RM3,000 per month was only part of the total remuneration paid to Dr. McCoy as it was not commensurate with his status as a consultant and senior obstetrician and gynecologist, and the 25% profit was simply a method of calculating the rest of the salary of Dr. McCoy. The learned judge opined that the SCIT erred –

- in concluding that just because the component of the payment of 25% of the net profit was over and above the monthly sum of RM3,000, the balance sum must be a bonus;
- when they failed to give due consideration to the fact that the payment to Dr. McCoy comprised 2 parts of a single contractual obligation.

The DGIR appealed to the Court of Appeal against the decision of the High Court. The issue for determination was whether the payment of 25% of profits to Dr. McCoy was a bonus or not.

**Decision:**

Appeal dismissed.

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The grounds of decision are summarized below:

1. The facts and grounds of decision of the following cases that went before the Supreme Court were reviewed:

- i) *DGIR V Highlands Malaya Plantation* [1988] 2 MLJ 99;
- ii) *DGIR v Harrison & Crosfield (M) Sdn. Bhd.* [1988] 2 MLJ 223.

The Court was of the view that the above cases could “easily be distinguished with the current appeal” in facts as well as “the distinguishing factors embedded in the respective agreements.”

2. In the Harrison & Crosfield case, the following factors are highlighted:
  - the “controversial bonus” was “compartmentalized” under the special heading of “*Additional Remuneration Scheme*”;
  - it had a “discretionary quality, unlike salaries that were beyond adjustment or review”;
  - the remuneration under this heading was over and above the salary given to the selected managerial staff;
3. In the Highlands Malaya Plantation case, the following factors are highlighted:
  - non-managerial staff were each paid a bonus “at the discretion of the (taxpayer)”;
  - the court concluded that payment could be “gratuitous”, or “contractual” – nevertheless, it is “still a bonus”;
  - “nomenclature wise”, both groups of recipients (non-managerial and managerial staff) “were paid pursuant to a scheme that carried the words ‘bonus’ ”;
4. There is nothing sinister in the way the taxpayer in the present case had framed its terms. “*It was merely arranging its business and financial affairs in such a way that would minimize its tax liability*”.
5. As there is no definition for the word “bonus” in the ITA, other sources must be referred to for the meaning of the word. The following are some of the “sources” referred to. (Salient phrases found in the meanings given are quoted.)
  - Words and Phrases Legally defined A-C (2<sup>nd</sup> Edition) – “*a boon or gift over (and) above which is normally due to the receiver,*”
  - *Shellford v Morsey* [191] 1 KB 154; – “*something apart from wages... an euphemism for ‘additional to wages’*.”
  - *Great Western Garment co. Ltd v Minister of National Revenue* [1948]1 D.L.R.225 – “*Something given in addition to what is ordinarily received by or strictly due to the recipient.*”
6. From the above definitions, it is concluded that the following are some characteristics of bonus:
  - It is in addition to the wages paid to an employee, something over and above the agreed remuneration;
  - It may be in the nature of a gift, a temporary boon or something freely given at the discretion of the giver, and includes payment which is legally due and contractually provided for.
7. To make sure that discussion of the meaning of “bonus” falls within the context of the ITA, “the presence of intention to make the deferred payment a part of remuneration and not a bonus payment, is a cogent factor”. With this in view, Dr. McCoy’s employment contract had to be scrutinized as a whole, and the Court came to the conclusion that the company was bound by the contract, hence “the 25% payment is not at the discretion of anyone,....being part and parcel of the salary agreement...”
8. In contrast to the above situation, where employees do receive bonuses, there is no guarantee of a bonus payment in every profitable year, as there is no obligation on the part of the

employer to pay something to the employee over and above the normal remuneration.

8. The Court's findings are restated as follows:

*"... read together with the salary of RM3000, which did not (sic) commensurate with a consultant's status and qualifications, the deferred payment by no figment of the imagination could be termed a bonus payment. It was part of his hard-earned income, though deferred and subject to profitability, as intended by parties."*

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

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