IN THE COURT OF APPEAL OF MALAYSIA

(APPELLATE JURISDICTION)

THE PALACE OF JUSTICE

PUTRAJAYA

CIVIL APPEAL NO. W-01-149-2010

Appellant

NV ALLIANCE SDN BHD

v.

Respondent

KETUA PENGARAH HASIL DALAM NEGERI

[In the matter of the High Court of Malaya at Kuala Lumpur,

Appellate and Special Powers Division, Civil Suit No. R1-14-04-2009]

[Plaintiff

Ketua Pengarah Hasil Dalam Negeri

v.

Defendant

NV Alliance Sdn Bhd]

CORAM:

RAUS SHARIF, PCA

MOHD HISHAMUDIN YUNUS, JCA

ANATHAM KASINATHER, JCA

JUDGMENT OF THE COURT

This is an appeal by the appellant company (NV Alliance Sdn. Bhd.) against the decision of the High Court of Kuala Lumpur (Appellate and Special Powers Division) of 22 February 2010. At the High Court

the learned High Court Judge had allowed the respondent's (the Director General of Inland Revenue) appeal against the decision of the Special Commissioners of Income Tax ('the Special Commissioners') who had, on appeal by appellant to them pursuant to section 99 of the Income Tax Act 1967 ('the Act'), against the tax assessment of the appellant by the respondent, allowed the appellant's appeal.

We, unanimously, are allowing the appeal with costs. Our grounds are as follows.

We begin by setting out briefly the facts.

The appellant is in the business of marketing of burial plots, urn compartments and funeral packages. In the course of its business the appellant needs the services of marketing personnel; and so it appoints agents to undertake the marketing functions. The agents are paid commissions for their work. But with the aim of motivating agents to increase sales, the appellant introduced incentive schemes. Under the incentive schemes, the agents on achieving certain set

sales targets are paid various types of incentives. One type of incentive is cash incentive.

The appellant in its tax returns had claimed deductions from its gross income expenses that it paid out to its employees as cash incentives under the incentive schemes. This claim for deductions is made pursuant to subsection (1) of section 33 of the Act. This subsection provides –

> **33. <u>Adjusted income generally.</u>**
>
> **(1) Subject to this Act, the adjusted income of a person from a source for the basis period for a year of assessment shall be an amount ascertained by deducting from the gross income of that person from that source for that period all outgoings and expenses wholly and exclusively incurred during that period by that person in the production of gross income from that source.**

It is common ground in this appeal and it is also the finding of the Special Commissioners that the cash incentive payments – the subject matter of this appeal – prima facie, do qualify for deductions by virtue of the above provision, being expenses wholly and

exclusively incurred by the appellant in the production of its gross income from a source.

However, notwithstanding this, the Director General of Inland Revenue ('the Director General') still refuses to allow the deductions on the ground that such cash incentive expenses are 'entertainment' expenses; as such, the deductions are not allowed by item (l) of subsection (1) of section 39 of the Act. Section 39(1)(l) as it stood then (i. e. before the coming into force of the amendment to the provision via the Finance Act 2003 (Act 631)) reads–

> **Deductions not allowed.**
>
> **(39) (1) Subject to any express provision of this Act, in ascertaining the adjusted income of any person from any source for the basis period for a year of assessment no deduction from the gross income from that source for that period shall be allowed in respect of –**
>
> **(a) – (k) [not applicable]**
>
> **(l) any expenses incurred in the provision of entertainment including any sums paid to an employee of that person**

for the purpose of defraying expenses incurred by that employee in the provision of entertainment:

In section 18 of the Act, 'entertainment' is defined as –

'entertainment' includes –

(a) the provision of food, drink, recreation or hospitality of any kind; or

(b) the provision of accommodation or travel in connection with or for the purpose of facilitating entertainment of the kind mentioned in paragraph (a),

by a person or an employee of his in connection with a trade or business carried on by that person.

There is no definition of the word 'hospitality' in the Act.

The present appeal concerns only the payment of cash incentives; whether such payments are entertainment expenses and hence

come within the ambit of item (l) of subsection (1) of section 39 of the Act.

The respondent/Director General takes the position that the cash incentives, as paid by the appellant to its employees, are expenses for 'hospitality' and are, therefore, entertainment expenses; and, therefore, item (l) of subsection (1) of section 39 of the Act applies.

At the hearing before them, the Special Commissioners found the facts which are set out in the Case Stated at paragraph 6 and allowed the appellant's appeal. In allowing the appeal, they gave their grounds of decision as follows:

> Now, the question before us is whether all the expenses incurred by the appellant are in a form of entertainment within the meaning of section 18 of the Act. Therefore we have to examine what is the true nature of expenses based on the evidence and documents adduced before us.
>
> According to Mr. Soo Wei Chian (AW1), an executive director of the appellant, all the expenses were made to the agents who achieve the next targets as set out in the respective notices to them. The incentives are in

the nature of additional remuneration paid to agents who met the sales target. The AW1 further explained that the reason for introducing the incentives is to motivate agents to work harder to increase the sales of the appellant.

According to Mr. Yap Hoi Chong (AW2) who work as an agent of the appellant, his income is in a form of commission based on his performance. Besides commission, he was also paid some incentives such as sales target incentives, agency sales competition incentives, quarterly incentives and cash incentives if he achieves certain target.

Based on the facts of the case, we are of the view that the expenses incurred are solely with the object of promoting the business. In other words the incentive is to motivate agents to work harder to increase the sales of the appellant as stated by AW1 and AW2. Therefore we are of the opinion that the expenses are [related to] the performance of profit earning operations would be of a revenue nature. We cannot agree with the respondent that the expenses are constitute as an entertainment within the meaning of section 18 of the Act; and therefore not allowable as deduction in the ascertaining of adjusted income pursuant to section 39(1)(l) of the Act.

In view of the above facts, we are of the opinion that the expenses in this appeal were wholly and exclusively incurred in the production of the appellant's gross income pursuant to section 33(1) of the Act and not prohibited from deduction by virtue of section 39(1)(l) of the Act before its amendment by Act 631 of 2003.

The Special Commissioners then made the following deciding order:

ADALAH DIPUTUSKAN bahawa perbelanjaan berikut:

Perbelanjaan	T/T/2000 (STTS)(RM)	T/T/2001 (RM)	T/T/2002 (RM)
Sales target incentives	238,948	87,993	127,295
Agency sales competition	180,000	103,710	-
Quarterly incentives	540,979	-	-
Cash incentives to agents	306,154	-	-

adalah dibenarkan sebagai tolakan di bawah seksyen 33(1) Akta Cukai Pendapatan 1967; dan penalty di bawah seksyen 113(2) Akta yang sama adalah tidak patut dikenakan dalam kes ini.

MAKA DENGAN INI ADALAH DIPERINTAHKAN bahawa rayuan ini dibenarkan.

DAN DIPERINTAHKAN SELANJUTNYA bahawa Notis-notis Taksiran bagi Tahun-tahun Taksiran 2000 (STTS), 2001 dan 2002 yang berkaitan dengan rayuan ini dipinda sejajar dengan keputusan di atas.

The respondent/Director General, dissatisfied with the decision of the Special Commissioners, appeal to the Appellate and Special Powers Division of the High Court of Kuala Lumpur. The High Court allowed the appeal and reversed the Order of the Special Commissioners. The learned High Court Judge, in her judgment, ruled that the cash incentives are 'entertainment' expenses and are, therefore, disallowed to be deducted by item (l) of subsection (1) of section 39 of the Act. She said:

24. In order to determine whether the 'incentives' come within the meaning 'entertainment' under section 18 of the Act, I refer to part of the judgment of Romer LJ in ***Bentleys, Stokes & Lawless v Beeson (Inspector of Taxes)*** cited in the case of ***Aspac Lubricants (Malaysia) Sdn Bhd v KPHDN*** (*supra*) as follows –

> … that the purpose must be the sole purpose … If the activity be undertaken with the object of both promoting business and also with some other purpose … then the paragraph is not satisfied though in the mind of the actor the business motive may predominate …

In the present case the incentives are paid through competitions or contests organized by the Respondent where there are rules and regulations, there are specified closing dates, winners will be announced and determined by the Respondent and top prizes and consolation prizes are given to winners. The incentives are paid as a reward for those sales agents who achieve the sales targets. Therefore apart from the commissions that the Respondent is contractually bound to pay under the agency agreements, the sales agents are rewarded for achieving sales targets. It is therefore apparent that the payment of incentives, though with the predominant purpose of promoting the Respondent's business, was also given or paid to reward those sales agents who achieve the

sales targets set. Therefore the incentives were not paid solely for the purpose of promoting the Respondent's business.

25. Further the Respondent does not include these incentives in the income statement of each sales agent. This indicates that the incentives were not part of the contractual commissions paid under the agency agreements. I agree with the appellant that these incentives are extra payments given to the sales agents over and above the commissions that they are paid for doing what they are contractually bound to do under the agency agreements. The agents are not required to fork out anything extra. Thus the incentive payments given by the Respondent are by nature gratuitous without consideration. I find that there is the element of hospitality in the incentives given based on the case of ***United Detergent Industries Sdn Bhd v Director General of Inland Revenue*** (*supra*) cited by the Appellant where the Court said –

> … the word "hospitality" connotes the action of entertaining someone without that someone having so subscribe towards the cost incurred by the host for the purpose of entertaining that someone.

Section 18 of the Act defines 'entertainment' to include "hospitality of any kind". Having considered the facts I find that the SCIT has

> erred when it concluded that the incentives do not come within the meaning of 'entertainment'.

With respect, on our part, we are unable to agree with the decision and reasoning of the learned High Court Judge. In our judgment, the cash incentive payments are not 'hospitality' expenses, and, hence, are not entertainment expenses. In other words, the cash incentive payments do not come under item (l) of subsection (1) of section 39 of the Act. It follows then that the appellant is entitled to the deductions claimed in respect of the cash incentive payments. We are in agreement with the submission of the learned counsel for the appellant that this is a case where the ***noscitur a sociis*** rule of statutory interpretation is applicable. According to this rule of interpretation, where two or more words which are susceptible of analogous meaning are coupled together in a statutory provision, they are understood to be used in their cognate sense. They take as it were, their colour from each other, the meaning of the more general being restricted to a sense analogous to that of the less general (**Maxwell on The Interpretation of Statutes**, 12th edn. p. 289). It follows then that in the present case the meaning of the more general

words '*or hospitality of any kind*' must be restricted to a sense analogous to that of the less general words, namely, '*food, drink, recreation*'. In other words, in determining as to whether or not the cash incentive expenses come within the meaning of '*or hospitality of any kind*', we have to take into account the words preceding that word, that is to say, the words '*food, drink, recreation*'. In our view, if the meaning to be given to the words '*or hospitality of any kind*' is limited accordingly, then, the cash incentives expenses clearly cannot come within the meaning of these words ('*or hospitality of any kind*').

Alternatively, we would arrive at the same finding if we were to apply the related ***ejusdem generis*** rule. According to this related rule of statutory interpretation, the meaning to be given to the general words '*or hospitality of any kind*' must be restricted to the same genus as '*food, drink, recreation*' (**Maxwell on The Interpretation of Statutes**, p. 297). In other words, the words 'or hospitality of any kind' must be given a meaning that is ***ejusdem generis*** with '*food, drink, recreation*'. If the meaning to the expression, '*or hospitality of any kind*' is so confined, clearly, it would exclude the payments of cash incentive.

We, accordingly, set aside the Order of the High Court and restore the Deciding Order of the Special Commissioners.

[Appeal allowed with costs]

(Dato' Mohd Hishamudin Yunus)
Judge, Court of Appeal
Palace of Justice
Putrajaya

Date of decision and grounds of judgment: 4 November 2011

Dato' W. S. W. Davidson, Encik Francis Tan Leh Kiah and Encik Cheh Keng Soon (*Messrs Azman Davidson & Co.*) for the appellant

Senior Revenue Counsel Cik Neng Juliana Ismail (*Office of the Inland Revenue Board Malaysia*) for the respondent