TAMAN EQUINE (M) SDN BHD

v.

KETUA PENGARAH HASIL DALAM NEGERI

High Court Malaya, Kuala Lumpur
Noorin Badaruddin J
[Civil Appeal No: WA-14-21-06-2020]
25 October 2021

Revenue Law: *Income tax — Payments made by appellant to Lembaga Perumahan dan Hartanah Selangor to obtain release of Bumiputera quota ("Payment") — Appeal against decision of Special Commissioners of Income Tax ("SCIT") who held said Payment was not deductible under s 33(1) Income Tax Act 1967 — Whether Payment a penalty or fine — Whether appellant not entitled to make claim for deduction in terms of public interest — Whether appellant had taken reasonable and genuine position in submitting its returns*

The appellant appealed under para 34 of Schedule 5 of the Income Tax Act 1967 ("ITA") against the whole of the decision of the Special Commissioners of Income Tax ("SCIT"). The SCIT had decided that the payments made by the appellant to Lembaga Perumahan dan Hartanah Selangor ("LPHS") to obtain the release of Bumiputera quota ("Payment") were not deductible under s 33(1) of the ITA and the respondent had correctly and reasonably imposed penalties under s 113(2) ITA at the rate of 25% on the additional assessments raised for the years of assessment 2011, 2012 and 2013. The appellant claimed that the SCIT erred in holding that the Payment was not deductible as it was a penalty or fine and that in terms of public interest, the appellant was not entitled to make a claim for deduction because if it was allowed, it would encourage property developers to avoid selling Bumiputera units to Bumiputera and leave the Government alone to address the racial imbalance problem in areas dominated by certain races.

Held (allowing the appellant's appeal):

(1) Without the Payment being made, the appellant would not have been able to sell the Bumiputera units to the non-Bumiputera purchasers and generate its income. The appellant's purpose or object behind the payment was to procure a benefit, which was purely a business one. The payment was made to enable the appellant to widen its group or class of people it could sell to. It was therefore a normal business payment in order to produce income and was wholly and exclusively incurred in the production of the appellant's gross income. Hence, the payment was deductible. (paras 16, 20, 22 & 23)

(2) The SCIT had failed to appreciate that nowhere in s 39(1) ITA did it stipulate that the Payment was non-deductible. Section 39(1) provided for the disallowance of the deduction of certain expenses. Therefore, when there was no express provision stipulating that expenses such as the Payment

herein was non-deductible, it was trite, more so in tax law, that one could only look at what was clearly stated in the Act and nothing was to be read in nor implied. (para 32)

(3) The SCIT had erred in making a finding that the Payment was not deductible as it was a penalty or fine. The payment consisted of an amount equivalent to 10% of the Bumiputera discount plus 5%. The 10% was not a penalty or fine. Only the 5% was called a 'denda'. The SCIT had stated as such. (paras 35 & 37)

(4) The deductibility of a penalty or fine was also not curtailed by s 39(1) ITA. Parliament had expressly disallowed the deduction of certain expenses under s 39(1). If Parliament had wished to limit the deduction of a penalty or fine, Parliament would have done so expressly. (para 49)

(5) The SCIT further erred when they stated that in terms of public interest, the appellant was not entitled to make a claim for deduction. The SCIT could not devise their own test for deduction as there was s 39(1) ITA where Parliament expressly excluded the deduction of certain expenses and nowhere in the ITA or any circulars for that matter stated that deduction was disallowed on policy basis. There could never be an issue of policy herein as the State Government had allowed the release of the Bumiputera units and as such the Payment made was legitimate and within the law. (paras 52-53)

(6) This was not a case where the taxpayer had filed an incorrect return by omitting or understating its income or gave incorrect information relating matter affecting its chargeability to tax. The appellant had taken reasonable and genuine position in submitting its returns. The respondent would have known regarding the deduction as the appellant had filed its tax returns and it could not be gainsaid that the deduction was only known after the audit was carried out on the appellant. (para 57)

Case(s) referred to:

BN Ketua Pengarah Hasil Dalam Negeri [2009] MSTC 3, 828 (refd)

British Columbia Ltd v. Canada [1999] 3 SCr 804 (refd)

British Insulated and Helsby Cables Limited v. Atherton [1926] AC 205 (refd)

Cape Brandy Syndicate v. IRC 12 TC 358 (refd)

DGIR v. LTS [1974] 1 MLRH 6 (refd)

Director-General Of Inland Revenue v. Kulim Rubber Plantations Ltd[1980] 1 MLRA 146 (refd)

Exxon Chemical (Malaysia) Sdn Bhd v. Ketua Pengarah Hasil Dalam Negeri [2005] 2 MLRA 335 (refd)

Income Tax Officer v. Ramesh Stone Wares [1998] 62 TTJ ASR 93 (refd)

Inland Revenue Commissioners v. Wesleyan and General Assurance Society [1946] 2 ALL ER 749 (refd)

Inland Revenue v. Carron Company 1968 SC (HL) 47 (refd)

L Sdn Bhd v. Comptroller General Of Inland Revenue [1972] 1 MLRA 1 (refd)

Lift & Shift India P Ltd, Mumbai v. Cit cen-iv Mumbai Ita No 5606/MUM/2015 (A.Y:2011-12) & ITA No 4521/MUM/2016 (A.Y:2012-13 (refd)

National Land Finance Co-Operative Society Ltd v. Director General Of Inland Revenue [1993] 1 MLRA 512 (refd)

Ketua Pengarah Hasil Dalam Negeri v. Firgos (Malaysia) Sdn Bhd [2013] MLRHU 876 (refd)

Ketua Pengarah Hasil Dalam Negeri v. Kim Thye & Co [1992] 1 MLRA 184 (refd)

Prima Nova Harta Development Sdn Bhd v. Ketua Pengarah Hasil Dalam Negeri (Appeal No: WA-14-7-12-2019) (Unreported) (refd)

Sovereign Teamwork (M) Sdn Bhd v. Director General of Inland Revenue (Case No WA-14-1-01-2020) (refd)

The Commissioner of Inland Revenue v. EC Warnes & Co Ltd [1919] 2 KB 444 (distd)

Legislation referred to:

Income Tax Act 1967, ss 33(1), 39(1), 44(6), 113(2), Schedule 5, Para 34

Counsel:

For the appellant: Vijey M Krishnan (William Wong with him); M/s Raja, Darryl & Loh

For the respondent: Muazmir Mohd Yusof Ahmad (Ahmad Isyak Mohd Hassan & Nordiana Sham with him); Senior Revenue Counsel/Revenue Counsel

JUDGMENT

Noorin Badaruddin J:

[1] This is an appeal made by way of Case Stated pursuant to para 34 of Schedule 5 of the Income Tax Act 1967 ("ITA") against the whole of the decision of the Special Commissioners of Income Tax ("SCIT"), as contained in the Deciding Order ("DO") dated 27 September 2019.

[2] Two issues were raised for the determination of the SCIT and in its DO, the SCIT had decided that:

i. the following Payments made by the appellant to Lembaga Perumahan dan Hartanah Selangor ("LPHS") to obtain the release of Bumiputera quota ("Payment") are not deductible under s 33(1) ITA:

ii. Year of Assessment	Payment (RM)
2011	332, 342.00
2012	3,349,271.00
2013	1,606,564.00

ii. the respondent had correctly and reasonably imposed penalties under s 113(2) at the rate of 25% on the additional assessments raised for the years of assessment 2011, 2012 and 2013.

Facts

[3] The appellant is principally engaged in property development.

[4] The appellant was required by the Selangor State Government to sell a percentage of units in the appellant's Equine Boulevard commercial project to Bumiputera purchasers. As an option, an application can be made to release the Bumiputera units that cannot be sold to non-Bumiputera purchasers and in turn a payment is required to be made to LPHS.

[5] A number of the Bumiputera units in the appellant's Equine Boulevard commercial project could not be sold. The appellant made the Payment to LPHS for the release of the Bumiputera units that could not be sold and claimed the Payment as business expenses. The appellant further took deduction for the Payment in question and the income arising from the project has also been brought to tax.

[6] The respondent conducted an audit in the appellant's premises on 7 September 2015 and on 21 June 2016 it raised the issue of the deductions taken by the appellant for the Payment in question. The respondent stated that the deductions are not allowed under s 33(1) ITA as they are said to be capital in nature. The respondent was of the view that the Payment was made to cancel the quota rights allocated to Bumiputera and subsequently to obtain rights to sell to non-Bumiputera.

[7] The appellant then responded and gave reasons as to why the Payment cannot be said to be capital in nature and that they are revenue expenditure wholly and exclusively incurred for the relevant year of assessments by the appellant in the production of its gross income under s 33(1) ITA vide letters dated 8 and 20 July 2016. In addition, a meeting was also held and took place between the appellant's tax agent and the respondent on 13 July 2016.

[8] The respondent had maintained its decision and disallowed the appellant's claim for the deduction.

Summary Of The Appellant's Contentions

[9] It is the appellant's contention that the Case Stated discloses errors of law and facts. It is argued that from the facts, clear and express provisions

for deduction and case law authorities, the Payment has met the test for deduction. In essence, the appellant relied on s 33(1) ITA and the decision of the High Court in *Prima Nova Harta Development Sdn Bhd v. Ketua Pengarah Hasil Dalam Negeri* (Appeal No: WA-14-7-12-2019) ("*Prima Nova Harta*").

[10] It is further argued that:

i. if the Payment is not deductible under s 33(1) ITA, the Payment would be deductible under s 44(6) ITA which explicitly provides that any gift of money made in the basis year to a State Government or local authority is deductible for that year in arriving at the total income, as the Payment constitutes a gift under s 44(6) ITA; and

ii. the Payment is not stipulated as non-deductible under s 39(1) ITA which expressly provides for the disallowance of the deduction of certain expenses.

Summary Of The Respondent's Contentions

[11] Summarily, it is the respondent's contention that the nature of the expenses incurred is for the purpose to get the permission of the State Authority to enable the reserved quota for the Bumiputera to be released so that the appellant can sell it to the non-Bumiputera. Thus, the Payment is argued to be capital in nature and the Payment was not incurred wholly and exclusively in the production of income as stipulated in s 33 ITA.

[12] The respondent submits that there is condition precedent before the sale of the units takes place to the non-Bumiputera. The Payment to the State Authority is said to be capital expenditure in nature as it was paid to obtain the permission for the appellant's production of income.

[13] The respondent added that the expenses being not made wholly and exclusively in the production of income was incurred after the completion of the said project and such expenditure does not form part of the development cost of the project.

Findings

[14] It is trite law that in order to qualify for deduction under s 33(1) ITA, the expenditure must be wholly and exclusively incurred in the production of the taxpayer's gross income. Section 33(1) ITA states that

> "Adjusted income generally
>
> 33. (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, including ..."

[15] The question whether a particular payment is capital or revenue is basically a question of fact and every case must be considered on its own facts (see *Director-General Of Inland Revenue v. Kulim Rubber Plantations Ltd*[1980] 1 MLRA 146).

[16] It cannot be disputed that in this case, without the Payment being made, the appellant would not have been able to sell the Bumiputera units to the non-Bumiputera purchasers and generate its income.

[17] The SCIT had relied on its earlier decision in *Prima Nova Harta*. However, the said decision had been overturned by the High Court. The High Court in *Prima Nova* and later in another case *Sovereign Teamwork (M) Sdn Bhd v. Director General of Inland Revenue* (Case No WA-14-1-01-2020) had held that contributions made to the State Government for the release of the Bumiputera status were deductible under s 33(1) ITA. The Court was of the view that by selling the Bumiputera lots to non-Bumiputera, it directly generates the taxpayer's income. However, to be able to do so, the applicant therein needs to return the Bumiputera discount to the State Government. As such the High Court was of the view that the expenses or payment made by the applicant therein were "wholly and exclusively" borne for the purpose of generating income as well as being closely related to the business of the applicant. Thus, such expenses should be made deductible under s 33(1) ITA.

[18] The scenario in *Prima Nova* is similar to the present case as the appellant herein is required to make the Payment to the State Government vide the LHPS for the Bumiputera units to be sold to the non-Bumiputera. The Payment is therefore directly related, incidental and relevant to the appellant's principal activity in its entirety as property developer.

[19] The appellant was required to sell a percentage of units in its Equine Boulevard commercial project to Bumiputera purchasers (see the letter from Pejabat Tanah dan Galian dated 15 February 1999 in p 198 of RIP 2). An option is given by the Selangor State Government in that if property developers are unable to sell Bumiputera units to Bumiputera purchasers and wish to obtain a release of the said units, the property developers may opt to make a payment to LPHS (see paras 4.2 and 6.2 of the Pekeliling Pengarah Tanah dan Galian Selangor Bilangan 1 Tahun 2011).

[20] The appellant, being unable to sell the Bumiputera units, opted to obtain the release of the units to sell to non-Bumiputera purchasers. It is clearly necessary and integral for the appellant to do so and it cannot be disputed that the Payment flowed from the act forming the essence of the appellant's business and done for the purpose to earn revenue. The Payment is therefore unavoidable for otherwise the appellant would not be able to generate its income. So it is obvious that the appellant's purpose or object behind the Payment is to procure a benefit, which is purely a business one.

[21] The respondent argued that the Payment was made to obtain permission for the appellant's production of income and that the Payment was made to comply with conditions imposed by the State Government who woud allocate certain percentage in order to enable the appellant to effectively generate income. It is contended that the Payment was not made wholly or exclusively in the production of income but just necessarily for the production of income.

[22] The respondent's argument is misconceived. The agreed fact is that without making the Payment the Bumiputera units cannot be transferred. Looking at the agreed facts and the dicta in *Prima Nova (supra)*, it is clear that the Payment is deductible.

[23] Further, it is of the considered view that the Payment is not of capital in nature as the appellant has all along, the right to sell. The Payment was made so as to enable the appellant to widen its group or class of people it can sell to. The Payment was therefore a normal business Payment in order to produce income. The Payment was therefore wholly and exclusively incurred in the production of the appellant's gross income.

[24] In *British Insulated and Helsby Cables Limited v. Atherton* [1926] AC 205 at p 212 of the report, Viscount Cave LC of the House of Lords had stated as follows:

> "It was made clear in the above cited cases of *Usher's Wiltshire Brewery v. Bruce* (1) and *Smith v. Incorporated Council of Law Reporting for England and Wales* (2) **that a sum of money expended, not of necessity and with a view to a direct and immediate benefit to the trade. but voluntarily and on the grounds of commercial expediency, and in order indirectly to facilitate the carrying on of the business. may yet be expended wholly and exclusively for the purposes of the trade**"
>
> [Emphasis Added]

[25] Since there is no definition of capital or revenue expenditure in the ITA, what is capital and revenue expenditure will depend on the facts of each case. Several cases which have recognised that a payment made to remove an obstacle to profitable trading is attributable to revenue are forwarded to this Court.

[26] In the case of *Inland Revenue v. Carron Company* 1968 SC (HL) 47, the taxpayer was incorporated by royal charter. The charter seriously impeded the profitable development of the company's business because it limited the company's borrowing powers and also restrictions on share transfers made it difficult to attract executives of a suitable calibre. The company decided to seek a supplementary charter to eliminate these impediment but some dissenting shareholders took legal action to indefinitely delay the matter. Eventually a settlement was negotiated, and the company paid £88,000 to the dissenting shareholders and £3,107 to obtain the supplementary charter. The House of Lords held that an allowable deduction was available for both these items as that money was spent to remove restrictions that prevented profits from being

earned. The House of Lords was of the view that there was no creation of new assets. The removal of the disadvantages by the supplementary charter enabled the company's business to be carried on more efficiently and in its day-to-day trading and therefore the advantage obtained was an income advantage.

[27] In the case of *Kulim Rubber Plantations Ltd (supra)*, the taxpayer owned extensive rubber plantations. It decided on a new policy by embarking on a large scale programme of oil-palm planting. To implement this policy and to raise funds it decided on selling the more outlying and less profitable rubber estates. The taxpayer had also employed agents and secretaries in the conduct of its business and had agreed that in the event of the sale of the whole or part of the estates, they would be entitled to compensation. The Federal Court held that where a company, in order to get rid of a contract which is of an onerous character or a servant whose continuance in service is undesirable in the company's interest, makes a payment in such circumstances it is properly to be treated as a revenue payment and a deductible expense.

[28] The cases such as the *Carron Company* and *Kulim Rubber Plantations Ltd (supra)* highlighted to this Court demonstrate that a payment made to remove an obstacle to profitable trading is deductible as there is no new asset created or enduring benefit (enduring benefit is attributed to capital as per the House of Lords in *British Insulated* and *Helsby Cables Limited (supra)* that has been acquired and is attributable to revenue. The House of Lords further stated:

> "Of course they obtained an advantage: **companies do not spend money either on capital or income account uniess they expect to obtain an advantage.** And money spent on income account, for example on durable repairs, may often yield an enduring advantage. In a case of this kind **what matters is the nature of the advantage for which the money was spent This money was spent to remove antiquated restrictions which were preventing profits from being earned, it created no new asset It did not even open new fields of trading which had previously been closed to the company. Its true purpose was to facilitate trading by enabling the company to engage a more competent manager and to borrow money required to finance the company's traditional trading operations under modern conditions.**"
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> [Emphasis Added]

[29] In *L Sdn Bhd v. Comptroller General Of Inland Revenue* [1972] 1 MLRA 1 the Court explained that if an expenditure relates to fixed capital (ie fixed assets), it may be regarded as capital expenditure. If an expenditure relates to circulating capital (ie stock-in-trade), it will be deductible.

[30] The appellant argued that in so far as the fixed capital versus circulating capital test is concerned, the same type of asset may be either a fixed asset or stock-in-trade according to the nature of the business. What is a capital asset in the hands of one person, may be a trading asset in the hands of another, and the nature of a receipt may consequently vary according to the nature of the trade in connection with which it arises. This Court agrees with the

appellant's contention that the units that a property developer builds are part of its stock-in-trade. The Bumiputera units therefore were the stock-in-trade of the appellant's business. The appellant received income from the sale of the Bumiputera units as the Payment was made in order to sell the Bumiputera units. In other words, the effect of the Payment was to achieve sales relating to the appellant's stock-in-trade, which is revenue payment in character as oppose to a capital asset.

[31] This court further agrees with the appellant that the Payment even if it is seen and found by the SCIT to be not wholly and exclusively incurred in the production of gross income, the Payment is deductible under s 44(6) ITA which explicitly provides that any gift of money made in the basis year to a State Government or local authority is deductible for that year in arriving at the total income. The Payment constitutes a gift under s 44(6) of the ITA. The Payment, being a contribution to the Government for each Bumiputera unit released, can be seen as being a gift or contribution in nature. Section 44(6) ITA provides:

> "44(6) Subject to subsection (12), there shall be deducted pursuant to this subsection from the aggregate income of a person for the relevant year reduced by any deduction falling to be made for that year in accordance with subsection (1) an amount equal to any gift of money made by him in the basis year for that year to the Government, a State Government, a local authority or an institution or organization approved for the purposes of this section by the Director General on the application of the institution or organization concerned:
>
> Provided that the amount to be deducted from the aggregate income of a company for the relevant year in respect of any gift of money made by that company to any institution or organization approved for the purposes of this section by the Director General shall not exceed five per cent of the aggregate income of the company in the relevant year"

[32] This Court is of the further considered view that the SCIT had failed to appreciate that nowhere in s 39(1) ITA stipulates that the Payment is non-deductible. Section 39(1) provides for the disallowance of the deduction of certain expenses. Therefore, when there is no express provision stipulating that expenses such as the Payment herein is non-deductible, it is trite, more so in tax law, that one can only look at what is clearly stated in the Act and nothing is to be read in nor implied.

[33] In *National Land Finance Co-Operative Society Ltd v. Director General Of Inland Revenue* [1993] 1 MLRA 512, the Supreme Court in quoting the principle of strict interpretation in *Cape Brandy Syndicate v. IRC* 12 TC 358 stated as follows:

> "There are ample authorities to show that Courts have refused to adopt a construction of a taxing Act which would impose liability when doubt exists. In *Re Micklewait* [1855] 11 Exch 452 it was held that a subject was not to be taxed without clear words. We realise that revenue from taxation is essential to enable Government to administer the country and that the Courts should help

in the collection of taxes whilst remaining fair to tax payers. Nevertheless, we should remind ourselves of the principle of strict interpretation as stated by Rowlatt J. in *Cape Brandy Syndicate v. IRC (supra)*:

> ... in a taxing Act one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used."

[34] In *Exxon Chemical (Malaysia) Sdn Bhd v. Ketua Pengarah Hasil Dalam Negeri* [2005] 2 MLRA 335 the Court of Appeal through the judgment of Gopal Sri Ram JCA (as he then was) stated that:

> "The maxim in revenue iaw is this: no clear provision; no tax. If there is any doubt then it must be resolved in the taxpayer's favour. See, *National Land Finance Co-Operative Society Ltd v. Director General Of Inland Revenue* [1993] 1 MLRA 512. The corollary of that proposition is that those parts in a revenue statute that favour the taxpayer must be read liberally. What learned counsel for revenue is asking us to do is to go the other way. That would be standing the true principle on its head."

[35] Apart from failing to properly direct their minds to the facts and the provisions of ss 33(1), 44(6) and 39(1) ITA, the SCIT further erred in making a finding that the Payment is not deductible as it is a penalty or fine.

[36] The SCIT in its Case Stated at para 10.28 states that:

> "10.28 Sepertimana kami putuskan dalam Rayuan *Prima Nova Harta Development Sdn Bhd*, oleh kerana jumlah dibayar adalah merupakan bayaran penalti atau denda maka bayaran tersebut bukanlah perbelanjaan kesemuanya dan semata-mata dibelanjakan dalam menghasilkan pendapatan kasar Perayu dan tidak boleh dibenarkan tolakan di bawah subseksyen 33(1) ACP 1967. Kami merujuk kepada kes *The Commissioner of Inland Revenue v. EC Warnes & Co Ltd* (12 TC 227) yang memutuskan seperti berikut:
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> > "... penalty was not a loss connected with and arising out of the Taxpayer's trade, hence, not deductible. Penalty or fine is not tax deductible as it is imposed upon a trader personally for a breach of law. Breaking the law cannot be considered to be trading transaction."

[37] The Payment consists of an amount equivalent to 10% of the Bumiputera discount plus 5%. The 10% is not a penalty or fine. Only the 5% is called a 'denda'. The SCIT had stated as such. The SCIT at para 10.14 of the Case Stated as follows:

> "10.14 Berdasarkan perenggan 3 surat PTGS bertarikh 28 Oktober 2010 tersebut, Perayu telah dikenakan syarat - bayaran balik potongan harga Bumiputera sebanyak 10% dan denda langgar syarat kuota 5%, pembayaran ini tidak terdapat di mana-mana perenggan dalam Pekeliling LPHS Bil. 1/2011 tersebut."

[38] The respondent in his written submission dated 7 August 2019 at para 17 had also stated to the same effect as follows:

> "17. The respondent would like to highlight that the Payments made to LPHS were consisted of:
>
> i. the refund of 10% for the Bumiputera quota; and
>
> ii. penalty of 5% for violating the terms of the quota to the State Government through LPHS"

[39] Therefore, it cannot be said that the 10% is a penalty or fine. In fact this Court is of the considered view that even the 5%, is not a penalty or fine.

[40] In *Black's Law Dictionary*, 'Penalty' is defined as "a punishment imposed by statute as a consequence of the commission of an offence". In the instant matter, the appellant is not being punished for any offence or for any violation of law. The Payment was made in order for the appellant to sell the Bumiputera units or that the units can be released to some other non-Bumiputera purchasers. The SCIT had made a fact finding that the appellant has not released the Bumiputera units before the approval was obtained. The SCIT stated at para 10.24 of the Case Stated that "tiada fakta dikemukakan bagi menunjukkan Perayu teiah membuat jualan sebelum kelulusan diberikan". As such, there was no violation of the law committed by the appellant. The fact that the State Government provides a release of the Bumiputera units means that it is clearly within the law. As such the 5% is therefore not penal in nature because it is not a punishment.

[41] In the case of *Income Tax Officer v. Ramesh Stone Wares* [1998] 62 TTJ ASR 93, the appellant therein made a claim on account of penal freight paid to the railway department. The appellant explained to the assessing officer that freight was originally charged by the railway department on coal keeping in view of the capacity of the wagon. The coal was weighed later on by the railway authorities and excess of the weight from the actually charged weight was liable for payment of freight as well as penal freight. The appellant therein pleaded that it had no control on the despatch of the coal by the coal company who was loading the coal in accordance with its own procedure and according to their own system. The matter was adjudicated upon the Commissioner (Appeals) who has given his findings *inter alia* that all the details of the freight charged lead to the conclusion that penal freight has been charged not for unlawful activity but on account of overloading of wagons over which the appellant had no control whatsoever. The Amritsar Income Tax appellant Tribunal found as follows:

> "4. The issue is to be decided from two angles. The first angle is whether the expenditure debited is penal in nature. We are of the opinion that the expenditure is not penal in nature because it is not the infringement of law but same is violation of contract that too not by the appellant but by his agent ie the Coal Authority of India. In terms of agreement, if coal is finally found

by the Railway authorities to be overloaded then the appellant has to pay additional freight charges which according to the terminology of the contract is called as penalty freight."

[42] In the case of *Lift & Shift India P Ltd, Mumbai v. Cit cen-iv*, Mumbai Ita No 5606/MUM/2015 (A.Y:2011-12) & ITA No 4521/MUM/2016 (A.Y:2012-13), the assessee paid certain sums of money towards compounding fees paid for transportation of lifts oversized and overweight as per the permissible limit under the Motor Vehicles Act 1988. The Mumbai Income Tax Tribunal held as follows:

"We find that this compounding fee was not in violation of law but an option is given to assessee to pay compounding fee for transportation of over dimensional consignment generally termed as overloading charges."

[43] It can be understood from the cases cited in the above that the nature of the payment made or expenses incurred by the taxpayer must be looked into in determining whether it is deductible. In *Inland Revenue Commissioners v. Wesleyan and General Assurance Society* [1946] 2 ALL ER 749, the English Court of Appeal had held that in construing a document for tax purposes a strained or forced construction is not to be placed on it either to attract or to avoid tax. Lord Greene MR in that case explained as follows:

"There have been cases in the past where what has been called "the substance of the transaction" has been thought to enable the court to construe a document in such a way as to attract tax. That doctrine was/hope, finally exploded by the decision of the House of Lords in *Inland Revenue Comrs v. Westminster (Duke)* (1). The argument of the Crown in the present case, when really understood, appears to me to be an attempt to resurrect it. The doctrine means no more than that the language that the parties use is not necessarily to be adopted as conclusive proof of what the legal relationship is. That is, indeed, a common principle of construction."

[44] The release of the Bumiputera quota was based on the Pekeliling Lembaga Perumahan dan Hartanah Selangor Bil. 1 Tahun 2011 (the "2011 Circular"). It is pertinent to note that nowhere in the 2011 Circular that states the 5% (or even the 10%) as penalty. The 2011 Circular only talks about a 20% penalty for every Bumiputera unit sold based on an inaccurate report (see para 6.3 of the 2011 Circular).

[45] However, in the Case Stated the SCIT decided that the 2011 Circular was not applicable but instead it is the Pekeliling Pengarah Tanah dan Galian Selangor Bilangan 3/2007 (the "2007 Circular"). According to the SCIT based on their experience that was the circular that they have referred to when the Majlis Mesyuarat Kerajaan Negeri (MMKN) decided on the determination of the Bumiputera quota in the execution of the State land development on 6 October 2010. The SCIT stated as follows:

"10.10 Kami telah meneliti keseluruhan keterangan dan dokumen yang dikemukakan oleh kedua-dua belah pihak dan mendapati Pekeliling Lembaga Perumahan dan Hartanah Selangor Bilangan 1 Tahun 2011 (Pekeliling

> LPHS Bil. 1/2011) yang dilampirkan daiam eks C1 di ms 21-31 adalah tidak berkaitan dengan Rayuan ini dan tidak membantu kami dalam membuat keputusan kami.
>
> 10.11 Ini kerana berdasarkan Perenggan 1, Pekeliling LPHS Bil. 1/2011 ini disediakan berikutan keputusan MMKN pada 10 Ogos 2011 dan berdasarkan Perenggan 7 pula, Pekeliling ini berkuatkuasa mulai 15 September 2011.
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> 10.12 Manakala, dalam Rayuan ini, merujuk kepada surat PTGS daiam eks C2 di ms 10-11 yang memaklumkan keputusan MMKN Selangor pada 6 Oktober 2010 yang meluluskan rayuan Perayu bagi pelepasan kouta jualan Bumiputera adalah bertarikh 28 Oktober 2010.
>
> 10.13 Ini jelas menunjukkan Pekeliling LPHS Bil. 1/2011 tidak berkaitan kerana pada ketika keputusan MMKN dibuat pada 6 Oktober 2010 dan surat PTGS dikeluarkan pada 28 Oktober 2010, Pekeliling LPHS Bil 1/2011 tidak lagi wujud dan berkuatkuasa.
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> 10.14 Berdasarkan perenggan 3 surat PTGS bertarikh 28 Oktober 2010 tersebut, Perayu telah dikenakan syarat bayaran balik potongan harga Bumiputera sebanyak 10% dan denda langgar syarat kuota 5% pembayaran ini tidak terdapat di mana-mana perenggan dalam Pekeliling LPHS Bil. 1/2011 tersebut.
>
> 10.15 Daripada pengalaman kami Pekeliling yang berkaitan adalah Pekeliling Pengarah Tanah dan Galian Selangor Bilangan 3/2007 (Pekeliling PTGS Bii 3/2007) berkenaan "Penetapan Kuota Bumiputera Dalam Perlaksanaan Pembangunan Tanah dan Lain-lain Perkara yang Berkaitan dengan Kuota Bumiputera". Pekeliling inilah yang menjadi rujukan kami kerana inilah Pekeliling yang berkuasa pada ketika MMKN membuat keputusan pada 6 Oktober 2010. Memandangkan Pekeliling ini tidak dilampirkan dalam mana-mana Ikatan Dokumen, kami lampirkan Pekeliling ini sebagai eks D untuk menjadi rujukan sekiranya ada rayuan lanjut oleh mana-mana pihak yang tidak berpuas hati dengan keputusan kami. Merujuk kepada Perenggan 4.2 Pekeliling yang menyatakan bahawa perlaksanaan arahan dalam Pekeliling ini berkuatkuasa mulai 30 Mei 2007."

[46] It is of the considered view that the SCIT has erred in taking into account the 2007 Circular for it was an agreed fact that the applicable circular is the 2011 Circular (see para 4 of the Statement of Agreed Facts). Therefore the 2007 Circular is irrelevant to the present matter. The SCIT cannot on its own accord take into consideration the 2007 Circular as it had not been referred to them by the parties. The SCIT cannot devise their own test for deduction. In any event, both the 2011 Circular and the 2007 Circular are not law and the payment imposed on the appellant for the release of the Bumiputera units cannot be said to be a penalty in the sense of it being a punishment. The Payment is incidental to the appellant's business and as such it is deductible.

[47] The case of *British Columbia Ltd v. Canada* [1999] 3 SCr 804 is highlighted to this Court. In that case, the central question in the appeal was whether the over-quota levy may be deducted as a business expense from a taxpayer's business income. The appellant therein carried on a poultry farm business in

British Columbia. It was a registered egg producer and, due to local market conditions, it decided to produce over-quota from 1984 to 1988. In 1988, an inspector from the B.C. Egg Marketing Board discovered the over-quota layers on the appellant's farm and the appellant paid an over-quota levy of approximately $270,000. When filing its returns under the Income Tax Act, the appellant included the profit from its over-quota production in its income. In 1988, the appellant deducted the over-quota levy as a business expense pursuant to ss 9(1) and 18(1)(a) of the Act, which resulted in a non-capital loss that was carried back to its 1985 taxation year. In its 1989 taxation year, the appellant deducted the interest paid on the unpaid balance of the levy and legal expenses incurred for representation in respect of the over-quota levy. Upon reassessment of its 1985, 1988, and 1989 tax returns, the Minister of National Revenue disallowed the deductions of the over-quota levy. In allowing the appeal of the appellant, the Supreme Court of Canada held that:

> "The over-quota levy is an allowable deduction pursuant to ss 9(1) and 18(1)(a). The levy was incurred as part of the appellant's day-to-day operations, and the decision to produce over-quota was a business decision made in order to realize income. The characterization of the levy as a "fine or penalty" is of no consequence because the income tax system does not distinguish among levies, fines and penalties."

[48] In *British Columbia Ltd v. Canada (supra)* the Supreme Court further stated that since the Act therein is not silent on the issue of restricting the deduction of some expenses incurred for the purpose of gaining income, there is a strong indication that Parliament did direct its attention to the question and that where it wished to limit the deduction of expenses or payments of fines and penalties, it did so expressly. The Court held as follows:

> "65 Moreover, given that Parliament has expressly turned its mind to the deduction of expenses associated with certain activities that are offences under the Criminal Code, outlined in s 67.5 of the Act, I do not find a legitimate role for judicial amendment on the general question of deductibility of fines and penalties. Since the Act is not silent on the issue of restricting the deduction of some expenses incurred for the purpose of gaining income, this is a strong indication that Parliament did direct its attention to the question and that [p 841] where it wished to limit the deduction of expenses or Payments of fines and penalties, it did so expressly, i am also sceptical that the deduction of fines and penalties provides the taxpayer with a "benefit" or "profit" - indeed, their purpose is to calculate the taxpayer's profit, which is then taxed."

[49] In the instant matter, the deductibility of a penalty or fine is also not curtailed by s 39(1) ITA. Parliament has expressly disallowed the deduction of certain expenses under s 39(1). If Parliament had wished to limit the deduction of a penalty or fine, Parliament would have done so expressly.

[50] The SCIT had also misdirected themselves, and erred in law and in fact, in relying on the case of *The Commissioner of Inland Revenue v. EC Warnes & Co Ltd* [1919] 2 KB 444. In that case, the taxpayer paid a penalty

of £2,000 after being sued on information by the Attorney General for breach of certain orders and proclamations. As such that case is not applicable to the present matter. In this appeal, the Payment was made to enable the appellant to obtain approval to sell the Bumiputera units to non-Bumiputera purchasers. No offence or wrongdoing was committed by the appellant and at the risk of repetition, the Payment cannot be said to be a fine or penalty.

[51] This court further finds that the SCIT had erred in their views when they stated that the appellant already received a reward or return when given the Bumiputera quota release, namely, the appellant was able to sell to non-Bumiputera at full price without discount. The SCIT stated that if the appellant were allowed to make a claim for deduction, the appellant would profit many times over, vide the sale of the Bumiputera units without discount, and a reduction in chargeable income (see paras 10.32 and 10.33 of the Case Stated). However, the fact remains that s 39(1) ITA expressly excluded the deduction of certain expenses. Further, the Payment made by the appellant was necessarily incidental and relevant to gaining or producing income and expenditure and is not disqualified from deduction as it involves the attainment of profit.

[52] The SCIT further erred when they stated that in terms of public interest, the appellant is not entitled to make a claim for deduction because if it is allowed, it would encourage property developers to avoid selling Bumiputera units to Bumiputera and leave the Government alone to address the racial imbalance problem in areas dominated by certain races (see para 10.34 of the Case Stated). As stated earlier, the SCIT cannot devise their own test for deduction as there is s 39(1) ITA where Parliament expressly excluded the deduction of certain expenses and nowhere in the ITA or any circulars for that matter stated that deduction is disallowed on policy basis. In *British Columbia Ltd v. Canada (supra)*, the Court had stated:

> "This is not an endorsement of a literalist approach to statutory interpretation, but a recognition that in applying the principle of interpretation to the Act, attention must be paid to the fact that the Act is one of the most detailed, complex, and comprehensive statutes in our legislative inventory and courts should be reluctant to embrace unexpressed notions of policy or principle in the guise of statutory interpretation."

[53] There can never be an issue of policy herein as the State Government had allowed the release of the Bumiputera units and as such the Payment made is legitimate and clearly within the law. In *DGIR v. LTS* [1974] 1 MLRH 6 Chang Min Tat J observed as follows:

> "But as was said in the Privy Council in the judgment of Their Lordships in *Minister of Finance v. Smith* [1927] AC 193 at p 197:
>
> > "There is nothing in the Act which points to any intention to curtail the statutory definition of income, and it does not appear appropriate under the circumstances to import any assumed moral or ethical standard, as controlling in a case such as this and the literal interpretation of the language employed."

> The statutory definition of chargeable income within the Act is the gross income adjusted to allow for such deductions as are properly allowed by the Act."

[54] On the issue of penalty, the Courts have stated that the discretion to impose penalty is not unfettered and must be exercise properly and reasonably. Penalties should not be imposed mechanically or automatically (see *Ketua Pengarah Hasil Dalam Negeri v. Kim Thye & Co* [1992] 1 MLRA 184, and *BN Ketua Pengarah Hasil Dalam Negeri* [2009] MSTC 3, 828).

[55] The appellant has submitted that it has at all material times acted in good faith, gave full co-operation, made full and frank disclosure, and obtained professional advice in managing its finance and tax affairs. Throughout the course of the audit, the appellant states that it had provided the respondent with all documents and information requested. The appellant had also explained to the respondent the specific circumstances surrounding the release and the Payment in its letters dated 8 and 20 July 2016.

[56] It is of the considered view that the appellant had acted in good faith and made full disclosure. In *Ketua Pengarah Hasil Dalam Negeri v. Firgos (Malaysia) Sdn Bhd* [2013] MLRHU 876, Zaleha Yusof J (as Her Ladyship then was) stated as follows:

> "[17] On the second issue, even the appellant's witness agreed that all the capital expenditures claimed for reinvestment allowance purposes were actually incurred by the respondent. During the cross-examination, he agreed that the respondent had made full disclosure in the Borang that were submitted in the Years of Assessment 2005-2007 and agreed that the audit team did not discover anything contrary to the information disclosed in the Borang. I therefore agree with the SCIT that the respondent had acted in good faith and made full disclosure. In *Ketua Pengarah Hasil Dalam Negeri v. Kim Thye & Co* [1992] 1 MLRA 184 it was highlighted that s 113(2) of the ITA is not a mandatory provision. This section clearly confers discretion on the appellant as to whether penalty should be imposed or not. What more the matter in dispute arose as a result of technical adjustment ie, due to a differing interpretation of the tax legislation by the respondent. Therefore, the decision of the SCIT in the second issue to my mind is also correct."

[57] This is not a case where the taxpayer had filed an incorrect return by omitting or understating its income or gave incorrect information relating matters affecting its chargeability to tax. The appellant had taken reasonable and genuine position in submitting its returns. It is of the considered view that the respondent would have known the deduction as the appellant had filed its tax returns and it cannot be gainsaid that the deduction was only known after the audit was carried out on the appellant.

Conclusion

[58] The decision of the SCIT cannot be sustained as it is wrong in law in light of the clear statutory provisions that support the fact that the Payment is deductible. There are merits in this appeal and the same is allowed and the decision of the SCIT, reversed.