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SPECIAL COMMISSIONER OF INCOME TAX

PUAN NIK SERENE BINTI NIK HASHIM

19 MAY 2023

SECTION 33(1) & SECTION 113(2) OF THE INCOME TAX ACT 1967

CMSB
V.
DIRECTOR GENERAL OF INLAND REVENUE
MOF. PKCP. 700-7/1/919 (2020)

The Taxpayer is principally engaged in the business of construction of dams and other related ancillary works, and is a wholly owned subsidiary of CIWE, a corporation incorporated in the People's Republic of China.

The Director General Inland Revenue ("DGIR") conducted tax investigation on the Taxpayer for the years of assessment ("YAs") 2012 to 2018. After series of correspondences, the DGIR raised the Notice of Assessment for YA 2018 and imposed penalty under Section 113(2) of the Income Tax Act 1967 ("ITA 1967") against the Taxpayer where the DGIR had disallowed the Appellant's expenditure claim pursuant to Section 33(1) ITA 1967 in relation to the total accumulated Management Fee claimed by the Taxpayer between the YAs 2012 to 2018 for the construction of the Mengkuang Dam Project and the Mak Sulong Pump House Project (collectively referred to as "the Projects"). The Management Fee was paid by the Taxpayer to CIWE.

The Taxpayer contended that the Management Fee was wholly and exclusively incurred for the completion of the Projects, which produced income for the Taxpayer. In completing the Projects, the Taxpayer had entered into two Management and Consultancy Service Agreements with CIWE on 17.6.2011 and 16.4.2015 respectively, whereby, the Taxpayer shall pay 5% of the contract value of the Projects to CIWE as Management Fee.

The DGIR asserted the Taxpayer had appointed two (2) sub-contractors to complete the Projects. 90% of the contract value for the Mengkuang Dam project were payment to the sub-contractor and balance of 10% for the Taxpayer. 95% of the contract value for Mak Sulong project were payment to the sub-contractor and balance of 5% was payment to CIWE. The Taxpayer's function was only to supervise and provide on-site management and supervisory services i.e. management service provider. The DGIR contended that any expenditure can only be allowed as a deduction under Section 33 (1) ITA 1967 if the expenses can be matched with the function offered by the Taxpayer in line with paragraph 11.5 of the Public Ruling No. 2/2009.

The DGIR argued that the Taxpayer should not make a claim based on the overall value of the contract but only based on the Taxpayer's function as a management service provider in which the income is generated through the contract. Therefore, the management fee expense claimed by the Appellant is not wholly and exclusively incurred in producing the Appellant's income.

In dismissing the Taxpayer's appeal, the SCIT held that the Taxpayer had failed to prove its case under paragraph 13 Schedule 5 ITA 1967 and the DGIR is justified in law to issue the Notice of Assessment for YA 2018. On the issue of penalty, the DGIR is justified in law and on facts to impose penalty under Section 113(2) of the ITA as the Taxpayer had submitted incorrect returns and gave wrong information affecting its own chargeability to tax.

Editorial Note:

The Taxpayer has the right to file an appeal against the decision by the SCIT within 21 days from the date of the decision.