



**TAX APPEAL - ALI BABA SCHEME - CONTRACT
TO PURCHASE STANDING TIMBER - TO
FRUSTRATES SECTION 39(1)(g) ITA 1967**

EMBUNAN HARIAN SDN BHD

v.

**DIRECTOR GENERAL OF INLAND REVENUE
[W-01(A)-450-08/2021]**



COURT OF APPEAL



**YA DATO' CHE RUZIMA BIN GHAZALI, HMR
YA DATO' HAJI AZMAN BIN ABDULLAH, HMR
YA DATO' AZMI BIN ARIFFIN, HMR**



23 MEI 2024

The Taxpayer filed an appeal against the decision of the High Court in dismissing its appeal against the decision the Special Commissioner of Income Tax (“SCIT”).

In 2010, the Taxpayer claimed a deduction under section 33(1) of the Income Tax Act 1967 (“ITA 1967”) on the amount of RM925,000 on the basis that the amount was a part payment from the total amount of RM4,600,000.00 for the purchase of logs from Syarikat Kuruak Sawmill Sdn Bhd (“SKS”). Upon audit, the amount claimed by the Taxpayer was disallowed by the Revenue under section 39(1)(g) of the ITA 1967 as the payment was found to be part of the payment by the Taxpayer to SKS to obtain the exclusive right to extract timber from the land area that had been awarded to SKS by the Terengganu State Authority.

Consequently, the Revenue raised an additional assessment for the Year of Assessment (“YA”) 2010. The Taxpayer disagreed with the assessment and filed an appeal under section 99 of the ITA 1967. The SCIT was of the opinion that the payment that was made by the Taxpayer to SKS by virtue of the Sale and Purchase Agreement dated 12.6.2006 (“Agreement”) was for the purpose of obtaining the exclusive right to extract timber from the land area which was awarded/licensed to SKS. The SCIT dismissed the Taxpayer’s appeal and confirmed the Notice of Additional Assessment dated 15.5.2014 for YA 2010. The Taxpayer then appealed to the High Court against the SCIT’s decision. The High Court held that there was no error committed by the SCIT in their conclusion of fact and law and dismissed the Taxpayer’s appeal resulting in the appeal to the Court of Appeal.

The Taxpayer submitted that it was principally engaged in the extraction and trading of timber logs. It was undisputed that the Taxpayer had incurred expenditures under the Stock Purchase Expense. The SCIT had found that the Stock Purchase Expenditure was incurred for the purchase of timber. Hence, the Stock Purchase Expenditure was deductible under section 33(1) of the ITA 1967 and did not fall under Section 39(1)(g) of the ITA 1967 as it was not for payment for the use of the license to extract timber and SKS did not transfer its license to the Taxpayer.

However, the Revenue argued that based on the Agreement, the Taxpayer assumed all the duties to pay the deposit and premiums and all other payments due from SKS, as a license holder, to the State Authority. Thus, the responsibility to pay all the premium deposits and royalties which was due to the State Government or any relevant authority from the license holder, lied on the Taxpayer. The fact that the payment of premiums and royalties were incurred by the Taxpayer was not disputed and the expenses were captured in the Taxpayer’s Profit and Loss Account for YA 2007, 2008 and 2009 as expenses for “Log premium and royalty”.

Based on the Agreement, the Taxpayer shall have the total rights over all the benefit derived from the land area. This amplified the fact that the Taxpayer had the exclusive rights over the land area. The Agreement also made it an obligation on part of the Taxpayer to make and maintain all the access and internal roads including all the necessary roads including drains culvert and bridges in the land area. Thus, the Agreement was not a mere sale and purchase agreement.

The Agreement also expressly stated that the Taxpayer would abide with all the rules and regulations and with the term and conditions of the permit and the Taxpayer would indemnify SKS against any claim or demands. Though the permits were issued to SKS and any actions taken would be taken against SKS, but it was also stated that whatever claims made against SKS, as the permit holder, would be indemnified by the Taxpayer. This signified the intention of the SKS to hand over all the affairs relating to the land area to the Taxpayer save only the permits was under its name. As such, the Agreement was for the Taxpayer to secure and obtain the exclusive rights to use SKS’s permit and license in order to extract timber from the land area.

The case of *Hup Cheong Timber*, as referred to by the Taxpayer, was distinguishable as the Taxpayer in that case, held such licence which was contrary to the present case before the court.

The Court of Appeal, by unanimous decision, dismissed the Taxpayer's appeal and affirmed the decision of the High Court with cost of RM10,000. The Court of Appeal was of the view that the High Court did not err by upholding the finding of the SCIT, the nature and character of the Agreement was to use the license and not for purchase of standing timber.

The Court of Appeal agreed that the Revenue was empowered under section 113(2) of the ITA 1967 to impose a penalty of up to 100% of the amount of tax.