DALAM MAHKAMAH RAYUAN MALAYSIA
(BIDANG KUASA RAYUAN)
RAYUAN SIVIL NO. J-01-61-2002

ANTARA

KETUA PENGARAH HASIL DALAM NEGERI …… PERAYU

DAN

PERBADANAN KEMAJUAN EKONOMI NEGERI JOHOR …… RESPONDEN

(Dalam Mahkamah Tinggi Malaya Di Johor Bahru
Rayuan Sivil No. 14-01-1999

ANTARA

KETUA PENGARAH HASIL DALAM NEGERI …… PERAYU

DAN

PERBADANAN KEMAJUAN EKONOMI NEGERI JOHOR …… RESPONDEN

CORAM:

MOHD GHAZALI BIN MOHD YUSOFF, JCA
LOW HOP BING, JCA
VINCENT NG KIM KHOAY, JCA

LOW HOP BING, JCA
(DELIVERING THE JUDGMENT OF THE COURT)

I. APPEAL

[1] On 30 April 1999, the Special Commissioners of Income Tax ("the Special Commissioners") delivered a deciding order to the

effect that the computations by the appellant, the Director General of Inland Revenue ("the Revenue") were wrong and so revised the Revenue's two notices of assessment.

[2] The Revenue, being dissatisfied, requested the Special Commissioners to state a case for the opinion of the High Court.

[3] The High Court affirmed the Special Commissioners' deciding order with costs.

[4] The Revenue has now appealed to this Court.

II. FACTUAL BACKGROUND

[5] The respondent ("the taxpayer") is a statutory body incorporated under the Johor State Enactment No. 4 of 1968.

[6] The taxpayer's principal activities are to develop land for industrial, agricultural, property, mining, logging and other corporate activities.

[7] The taxpayer has two sources of income viz business and dividend.

[8] In exercise of the powers under s.127 of the Income Tax Act 1967 ("the Act"), the Minister of Finance granted to the taxpayer the following exemptions from payment of taxes:

Year of Assessment	Exemption
1980 to 1990	All income.
1991	All income except dividend income and development tax.
1992 to 1996	All income except dividend income and development tax.

(For brevity and convenience, a reference hereinafter to a section is a reference to that section in the Act).

[9] The instant appeal concerns the exemptions for only two years of assessment viz **1991** and **1992.**

[10] **I**n 1990 and 1991, the taxpayer made gifts of money to the State Government of Johor and claimed deductions for them from the taxpayer's non-exempt dividend income.

[11] Although the Revenue had, under s.44(6), allowed the deductions claimed by the taxpayer, the Revenue had applied an apportionment formula and apportioned the deductions between the taxpayer's non-exempt dividend income and the exempt business income. Consequently, the Revenue issued two notices of assessment, both dated 20 November 1995, and raised assessments on the taxpayer as follows:

Year of Assessment	Tax payable
1991	RM2,824,507.62
1992	RM1,978,744.94

[12] As alluded to above, the Special Commissioners had on the taxpayer's appeal revised these two notices of assessment, and the High Court had affirmed the Special Commissioners' deciding order.

[13] In the instant appeal, the parties shared a common ground in raising three questions for determination viz the meaning of the word "income", the exemption and the apportionment formula.

III. MEANING OF "INCOME" UNDER S.127(5)

[14] The first question is whether the word "income" in s.127(5) means gross income or chargeable income. The second question is whether the exemptions of payment of income tax are to be given at the gross income level or the chargeable income level. These two questions may be conveniently considered together.

[15] The Revenue's learned legal officer, Ms Hazlina bt Hussain (assisted by Mr Mohd Harris bin Hanapi and Ms Zaleha bt Adam) submitted that the word "income" means chargeable income and not gross income, based on:

(1) **MCI Society Ltd v Ketua Pengarah Hasil Dalam Negeri (1995) MSTC 2,272;**

(2) **Ketua Pengarah Hasil Dalam Negeri v MCI Society Ltd (2000) MSTC 3,792 CA;** and

(3) **Lower Perak Co-operative Society v Ketua Pengarah Hasil Dalam Negeri (1994) 2 MLJ 713 SC.**

[16] Learned counsel Mr. Md Ali bin Zaitun (Mr. Kunasegaran with him) responded for the taxpayer that the word "income" means gross income, and contended that in *MCI Society, supra*, the relevant judgments were silent on the meaning of the word "income", while *Lower Perak Co-operative Society, supra,* is distinguishable, as co-operative societies have to seek exemption under para 6 of the Schedule to the Act, while the exemption granted in favour of the taxpayer in the instant appeal is as of right.

[17] My analysis of the relevant factual background reveals that for the years of assessment **1991** and **1992**, the exemption did not include dividend income.

[18] S.127(5) allows any income which is exempt from tax by virtue of s.127, such as business income in the instant appeal, to be disregarded for the purposes of the Act. It reads as follows:

"(5) Any income which is exempt from tax by virtue of this section shall be disregarded for the purposes of this Act:
Provided that –
(a) [not relevant]; and

(b) [not relevant].”

[19] S.2(2) makes a general reference to “income” in the following words:

> “(2) Any reference in this Act to income shall, if the income is not described as being income of a particular kind, be construed as a reference to income generally or to gross, adjusted, statutory, aggregate, total or chargeable income as the context and circumstances may require”.

[20] The general reference to the word “income” in s.2(2) is highly volatile, as the precise meaning of the word “income” is to be dictated by reference to the context and circumstances. “It is a word difficult and perhaps impossible to define in a precise general formula.” : V.S. Sundaram’s “Law of Income Tax in India”, 12th edn. Vol.1 p.570, applied in *MC1 Society, supra,* by the Special Commissioners who added that ”It has different meanings in the different sections of the Act.”

[21] S.5 helps to illuminate the meaning of the word “income” to a great extent, by setting out the various types of income, for the purpose of ascertaining chargeable income. The “Graphic representation of the system” of ascertaining the “Total Income from a Business” at p.275 of Dr. Arjunan Subramaniam’s “Malaysian Taxation System 2003” is comprehensive and merits reproduction as follows:

Graphic representation of the system

Gross income - section 2
less
Allowable expenses - section 33
equals
Adjusted income - section 41
plus
Balancing charges - section 42
less
Capital allowances - section 42
equals
Statutory income - section 42
less
Business losses brought forward from previous years - section 43(2)
plus
Statutory income from other sources-section 43(1)(b)
plus
Recoveries from prospecting expenditure or qualifying farm expenditure – section 43(1)(c)
equals
Aggregate income
less
* Adjusted business loss for the current year - section 44(2) *Mining expenditure - Schedule 4 *Farm expenditure - Schedule 4A *Pre-operational business expenditure - Schedule 4B or 4C, loss * Approved donations - sections 44(6), 44(6A), 44(8), (9), (10), (11)
equals
Total Income
less
Personal reliefs (for a resident individual) sections 46 to 49
equals
Chargeable income - section 45

[22] This graphic representation shows that gross income and chargeable income are polarised. Consequently, the meaning to be attributed to the word "income" would affect the tax liability of the taxpayer.

[23] To be disregarded under the Act, an exemption from tax should legally be deducted or claimed from the chargeable income and not the gross income. This is because gross income *per se* may or may not be exigible to tax at all. When no tax is exigible, there is no question or necessity for the taxpayer to utilise or claim the exemption. In the context of s.127(5), exemption means immunity, dispensation, exclusion, freedom, relief or exoneration from tax (see "The New Oxford Thesaurus of English" 2000).

[24] It is essential to hark back to the simple and basic rule that "income tax is a tax on income": per **Lord Macnaghten in London County Council v AG (1901) AC 26; Raja's Commercial College v Gian Singh & Co. Ltd (1976) 2 MLJ 41 PC;** and *Lower Perak Co-operative Housing Society Bhd, supra.* In other words, where there is no income, there can be no liability to tax, in which case no question of exemption can ever arise. Exemption is only relevant when there is chargeable income, but not otherwise.

[25] Strong support for my view may be found in *Lower Perak Co-operative Housing Society Bhd, supra, at p. 752* where the Supreme Court, speaking through Edgar Joseph Jr SCJ (as he

then was) held that a tax exemption is only given after liability to tax has been determined, as clarified in the following passage:

> "Where its business dealings result in a profit which is income, liability to income tax arises, subject to the right of a co-operative society to claim exemption under para 12 of Sch 6 for the first five years of its trading or business dealings. In other words, there must be liability to income tax first and then only the question of claiming exemption under 12 of Sch 6 arises."

[26] I therefore uphold the submission presented for the Revenue that the word "income" means "chargeable income" and, hence, tax exemption is given at the chargeable income level. In the circumstances, I am unable to accept the aforesaid argument advanced for the taxpayer.

IV. REVENUE'S APPORTIONMENT FORMULA

[27] The third and final question is whether the Revenue's apportionment formula is lawful and applicable.

[28] The Revenue relied on **Daya Leasing Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri (2005) 2 CLJ 449 CA**, to support the submission that as the exemption does not include dividend income, it is necessary for the Revenue to apportion the taxpayer's chargeable income between dividend income and business income and apply the apportionment formula to the gifts of money

between the non-exempt dividend income and the exempt business income.

[29] The taxpayer argued that the facts in *Daya Leasing, supra*, are different in that Daya Leasing ran two types of business namely viz leasing business and non-leasing business, but the two businesses shared common expenses like rental, staff salaries etc and as the expenses are common to both the businesses, the expenses deductible from the businesses are unidentifiable.

[30] I would now put in proper perspective the facts in *Daya Leasing, supra*. The taxpayer there was engaged in giving leasing, factoring and hire purchase financing facilities. There were expenses and interest payments on loans from the taxpayer's holding company common to both the leasing and non-leasing businesses which required apportionment between the two sources. The taxpayer was unable to specifically attribute the exact amount of the common expenses to the respective leasing and non-leasing businesses. The Revenue's formula for apportionment of the common expenses included the entire lease rentals, viz both the interest and capital elements, ignoring the capital element in the lease rentals. The taxpayer argued that it was only the interest element that had to be taken into account in respect of the gross income of the leasing business in line with the manner of ascertaining the gross income of the non-leasing business. The majority of the Special Commissioners upheld the Revenue's apportionment formula. However, the High Court disagreed and

held that the principal should not be taken into account for the apportionment of the common expenses in lease financing as there was no provision in the Act, or the Income Tax (Leasing) Regulations 1986, to prescribe the manner of doing so in respect of different income sources. The Revenue's appeal was allowed by the Court of Appeal. In setting aside the High Court decision, the Court of Appeal affirmed the Special Commissioners' majority view. The Court of Appeal held, *inter alia*, that the common expenses incurred had to be apportioned as implied in s.33(1) and so the Revenue's apportionment was in compliance with the law: per Augustine Paul JCA (now FCJ) at p.464 c-d. At p.463, the Court of Appeal provided the reasons as follows:

> "Where there are two or more sources of income for a person and the expenses are identifiable and separable there will be no difficulty in ascertaining the adjusted income for each source. However, there will be instances when the expenses of two or more sources are not separable as they are common to the sources. As s.33(1) of the Act requires a deduction of the expenses of a source from the gross income of that source for the purposes of ascertaining the adjusted income of the sources the question that arises for determination is whether the section empowers the appellant to apportion the expenses. The power to apportion the expenses can be implied in s.33(1) of the Act in view of the need to ascertain the adjusted income…. If s.33(1) is to be strictly construed the appellant will be unable to identify the expenses separately where they are

mixed with the result that the adjusted income of the sources cannot be ascertained. This will defeat the object of s.33(1) and bring the machinery of tax assessment to a halt. This will not happen in the interpretation of ordinary statutes as one of the salutary canons of construction in such cases is that Parliament does not act in vain. The courts lean against a construction which reduces a statute to futility. A statute must be so construed so as to make it effective and operative on the principle expressed in the maxim *ut res magis valeat quam pareat* (that the thing may rather have effect than be destroyed in order that the thing may be valid rather than invalid)".

[31] The factual matrix in *Daya Leasing, supra*, bears substantial similarity to the factual background in the instant appeal, particularly in relation to the two unidentifiable sources of income eg the non-exempt dividend income and the exempt business income in the instant appeal. Applying the apportionment formula in *Daya Leasing, supra,* to the instant appeal, I am of the view that the Revenue's apportionment of the deduction for the gifts of money between the taxpayer's non-exempt dividend income and the exempt business income is justified and lawful. Under s.44(6), gifts of money are deductible from the taxpayer's aggregate income. S.5 which sets out the requisite steps, as simplified in the "G*raphic representation", supra*, may now be narrowed down as follows:

Gross Income
less
Allowable Expenses
equals
Adjusted Income
less
Capital Allowances
equals
Statutory Income
less
Unabsorbed Business losses brought forward
equals
Aggregate Income
less
Approved business donations and current business losses
equals
Total Income
less
Personal reliefs (individuals)
equals
Chargeable Income **Apply Tax Rate** **Tax Payable**

[32] In line with the steps set out in s.5 and the apportionment implied in s.33(1), the Revenue has produced an apportionment formula to effectively apportion the gifts of money between the non-exempt dividend income and exempt business income. For this purpose, gifts of money made to the State Government of Johor and claimed by the taxpayer as deductions under s.44(6) were apportioned accordingly. The total amount of the gifts claimed by the taxpayer could not be allowed against only one

source of income when the aggregate income of the taxpayer consists of the business income source and the dividend income source. The apportionment formula used by the Revenue is completely consistent with the approach adopted and recognised by this Court in *Daya Leasing, supra*. The answer to the third and final question is therefore in the affirmative.

V. CONCLUSION

[33] On the foregoing grounds, the deciding order of the Special Commissioners, and the High Court judgment affirming it, are erroneous and unsustainable. Hence, this appeal is allowed with costs. The deciding order and the High Court judgment are set aside. The Revenue's apportionment formula and two notices of assessment are upheld. Deposit to be refunded to the Revenue as appellant.

[34] My learned brothers Mohd Ghazali bin Mohd Yusoff and Vincent Ng Kim Khoay, JJCA have read this judgment in draft and have expressed their agreement to make it the judgment of the Court.

T.T
DATUK WIRA LOW HOP BING
Judge
Court of Appeal, Malaysia
Putrajaya.

Dated this 10th day of April 2009.

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REFERENCE:

1. **MCI Society Ltd v Ketua Pengarah Hasil Dalam Negeri (1995) MSTC 2,272;**

2. **Ketua Pengarah Hasil Dalam Negeri v MCI Society Ltd (2000) MSTC 3,792 CA;**

3. **Lower Perak Co-operative Society v Ketua Pengarah Hasil Dalam Negeri (1994) 2 MLJ 713 SC;**

4. **Lord Macnaghten in London County Council v AG (1901) AC 26;**

5. **Raja's Commercial College v Gian Singh & Co. Ltd (1976) 2 MLJ 41 PC;**

6. **Lower Perak Co-operative Housing Society Bhd v Ketua Pengarah Hasil Dalam Negeri (1994) 2 MLJ 713, 752 SC;**

7. **Perak Co-operative Housing Society Bhd (1994) 1 p. 752;** and

8. **Daya Leasing Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri (2005) 2 CLJ 449 CA.**