DALAM MAHKAMAH RAYUAN MALAYSIA
(BIDANGKUASA RAYUAN)
RAYUAN SIVIL NO. W-01-52-04

ANTARA

KETUA PENGARAH HASIL DALAM NEGERI …PERAYU

DAN

STERUDA SDN BHD …RESPONDEN

[Dalam perkara mengenai Rayuan Sivil No.R3-14-8-1998
di dalam Mahkamah Tinggi Malaya di Kuala Lumpur

Antara

Steruda Sdn Bhd …Perayu

Dan

Ketua Pengarah Hasil Dalam Negeri …Responden]

CORAM: SURIYADI HALIM OMAR, JCA
ZAINUN ALI, JCA
WAN ADNAN MUHAMAD, JCA

JUDGMENT OF THE COURT

The appeal heard by this panel was dismissed with costs.

The issue for our consideration was whether the year-end payment of 25% of net profit of Steruda Sdn Bhd (the respondent) to one Dr.

Ronald Stephen McCoy was a bonus payment or not. If it was, then it would be taxable as against the respondent, except the equivalent of two-twelfths of his salary of that payment. If not, it then becomes a part of Dr. McCoy's salary, and the whole amount would be deductible from the respondent's gross income and thus he would pay less tax. The restriction of deductibility regarding the bonus is legislated under s. 39(1) (h) of the Income Tax Act, 1967 (the Act) a provision introduced by Act A273 effective from year of assessment 1975 onwards. The latter provision, repealed later by Act 619, reads as follows:

> "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) ….;
>
> (h) any sum paid by way of a bonus to an employee in excess of one thousand ringgit or two-twelfths of his wages or salary whichever is the greater…."

To appreciate the current appeal it is necessary that a brief clarification regarding the concept of the taxability of a person be made. Subject to section 3 of the Act income tax shall be charged for each year of assessment upon income of any person accruing or derived from Malaysia, or received in Malaysia from outside Malaysia.

‘Person’ has a special meaning, and in the Act it includes a company, a body of persons, a corporation sole and even an individual though not a partnership.

The income tax of a person is usually determined by the Ketua Pengarah Hasil Dalam Negeri (the appellant) after adjustments have been made from his gross income, with the resulting amount being ‘adjusted income’, in order to arrive at a chargeable income. The relevant provision on ‘adjusted income’ is section 33 of the Act and it reads:

> “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 the period all outgoing and expenses wholly and exclusively incurred during that period by that person in the production of gross income from that source, including -
> (a) …
> (d) such other deductions as may be prescribed.”

Subsequently a revised assessment may be raised, on the grounds that the initial assessment is inadequate or the initial assessment has been wrongly assessed, additional chargeable income is detected, tax having been over assessed or actual income exceeds estimated income or vice versa. Be it for the initial assessment or revised one,

a taxpayer aggrieved by the assessment may file an appeal to the appellant, who on receipt of a notice of appeal under section 99 may review the assessment, and if the reviewed assessment is agreed upon, shall be deemed to be final and conclusive. Otherwise the matter may proceed to the Special Commissioners.

Either party to proceedings before the Special Commissioners may appeal on a question of law against a deciding order made in those proceedings, or require the latter to state a case for the opinion of the High Court. A right of appeal against the decisions of the High Court on cases stated in respect of questions of law dealt by it is provided for statutorily in the Act.

We now touch on the facts of the case and they are as follows. The respondent is a private limited company incorporated on 21.6.1975 and provides consultancy services in gynecology, obstetrics, and other branches of medicine. On 12.7.1976 the respondent entered into an employment agreement with the abovementioned Dr. McCoy, a shareholder and director of the respondent. Amongst the terms of the agreement were that Dr. McCoy was to be paid RM3,000.00 per month plus an annual 25% profit of the clinic. The detailed employment terms read as follows:

> "NOW IT IS HEREBY AGREED as follows:
>
> ….

(5) As remuneration for the service to be provided by the Consultant under this Agreement, the Employer shall:

(a) pay the Consultant $3,000 per month plus 25% of net profit of the clinic;…"

Later the appellant revised the tax computations of the respondent for the assessment years of 1978 to 1984. Seven notices of additional assessments dated 1.10.1986 were issued pursuant to the Act. By the issuance of those notices of additional assessment, it was obvious that the appellant had disallowed the deduction of Dr. McCoy's remuneration of 25% of net profit of the clinic from the gross income of the respondent for tax purposes. Only two-twelfths of the full 25% of the net profit of the clinic received by the latter was allowed to be deducted from the respondent's gross income. The appellant ventilated that in the event Dr. Mc Coy did not get the 25% net profit of the clinic for want of profits, his remuneration would be restricted to his monthly income of RM3, 000.00. In a nutshell, that sum being a bonus payment, was caught by s. 39(1) (h) of the Act.

The respondent had appealed to the appellant against that revised tax computation and the additional assessments but was unsuccessful. In the proceedings before the Special Commissioners of Income Tax, the respondent again argued that the payment of 25% of net profit of the clinic was part of the remuneration of Dr. Mc Coy as provided for under the Employment Agreement of 12.7.1976, and not a bonus payment. That being so, the whole amount was

deductible under s. 33 (1) of the Act, and not caught by s. 39(1) (h) of the Act. Regretfully the respondent also failed and the matter was referred to the High Court by way of case stated pursuant to paragraph 34 of the fifth Schedule of the Act.

At the High Court, with the onus on it to establish that it was not a bonus payment, the respondent successfully convinced the learned judge to reverse the finding of the Special Commissioners (*paragraph 13 Schedule 5*). The learned judge concluded that the sum of RM3, 000.00 a month was not a normal remuneration as it did not commensurate with the status of Dr. Mc Coy as a consultant and a senior obstetrician and gynecologist. The learned judge opined that the RM3, 000.00 per month was only part of his total remuneration, with the 25% profit being simply a method of calculating the rest of the salary of Dr. R.S. Mc Coy.

The learned judge opined that the Special Commissioners erred when they concluded that just because the component of payment of 25% of the net profit was over and above the monthly sum of RM3, 000.00, the balance sum must be a bonus. Further the Special Commissioners erred when they failed to give due consideration to the fact that the payment to Dr. Mc Coy comprised two parts of a single contractual obligation.

Being dissatisfied with that finding the appellant filed the relevant notice of appeal hence the matter before us. The appellant in the course of the appeal had occasion to refer to three cases for our

consideration. They were *Saledy Sdn Bhd v Director General of Inland Revenue [1994] 3 CLJ 492; Director General of Inland Revenue v Highlands Malaya Plantation [1988] 2 MLJ 99* and *Director General of Inland Revenue v Harrisons & Crosfield (M) Sdn Bhd [1988] 2 MLJ 223*. In all these cases, the issues were the same, namely whether the additional remuneration received by the taxpayers, provided for in employment agreements were bonus payments or not.

The facts of *Director General of Inland Revenue v Harrisons & Crosfield (M) Sdn Bhd* are as follows. The respondent had employed several expatriates and a local executive, amongst many others, on the management staff, and were remunerated inter alia with paid fixed salaries and additional remuneration under a scheme called Additional Remuneration Scheme. The Additional Remuneration Scheme was based upon a percentage of the combined profits of the respondent. Another scheme which was in the nature of a bonus scheme also ran side by side with this Additional Remuneration Scheme but suffice to say that eligibility to join the latter was based on the discretion of the management. Once a person was under that scheme he was not entitled to the parallel bonus scheme (paragraph 11 of the Rules of the Scheme). The appellant had concluded that the Additional Remuneration Scheme was in fact a form of bonus and thus had disallowed any deduction of the payments from the respondent's income. The appellant had submitted that s. 39(1) (h) was applicable.

For better appreciation of this case we reproduce the relevant contractual provisions in the letter of appointment, and they are as follows:

> "*Salary*: At the rate of M$2,100 per month. This salary includes an amount of M$400 per month consolidated from the additional remuneration scheme. (Please see below.)
>
> *Additional Remuneration Scheme*: You would be entitled to participate in profits under the rules of the additional remuneration scheme at the rate of ¼% of the adjusted net profits of Harrisons & Crosfield (Malaysia) Sdn. Bhd.
>
> The basis of participation of the staff as a whole is *subject to review annually* at 30 June and we must reserve the right to review individual *rates* at the same time. The amount of M$400 per month consolidated into basic salary is deductible from any amount of A.R.S becoming due for *payment*."

Apart from the above terms there were other connected provisions that showed that the payments were reviewable and therefore not fixed. Under Rule 5(a) and (c) of the Rules the additional remuneration due to the recipient would be a sum equivalent to a percentage of the profits of the respondent. The Supreme Court in the course of its deliberation found that the Additional Remuneration

Scheme was of a separate and distinct character to that of the fixed salary. That being so the Additional Remuneration Scheme could not be regarded as a deferred salary. The court also found that the rate of the Additional remuneration Scheme was reviewable by the respondent in contrast to fixed salaries.

In *Director General of Inland Revenue v Highlands Malaya Plantation [1988] 2 MLJ 99* the terms could only be gauged from the following passages as the specific provisions were not reproduced by the court:

> "The managerial staff were each paid a monthly salary and in addition thereto they were entitled to participate in the group bonus scheme in accordance with the standard letters of appointment. On the other hand, the clerical staff (i.e. the non-managerial staff) were each paid a bonus at the discretion of the respondent as there was no contractual obligation on the part of the respondent.
>
> In respect of the managerial staff, the scheme came into operation on 1 January 1961. It was based on a number of factors, vis. status of employees, amount of salary drawn, duration of service and planted acreage managed, for which points would be given for equitable distribution of a provision created by reserving 4% of the agricultural profits of "the groups". The amount of payment varied with the number of points earned by each participant.

The respondent had been making bonus payments to its managerial staff since the scheme was introduced. As regards the non-managerial staff, for the last 12 years or so they received bonus payments annually in excess of two months' salary. The respondent does not dispute its liability to tax in respect of the discretionary bonus payments to its non-managerial staff in excess of two months salary. On the other hand, the managerial staff were paid under a contractual obligation tied to profitability and on appropriation of 4% of the agricultural profits of "the group".

For the year of assessment 1975, the appellant disallowed for deduction from the gross income of the respondent the bonus paid to the managerial staff pursuant to the scheme in excess of the limits stipulated in section 39(1)(h) of the Income Tax Act 1967. Accordingly, by a notice of assessment dated 5 January 1980 the appellant informed the respondent that an additional assessment in the sum of $319,066.50 had been made for the year of assessment 1975.

The respondent contended that the additional remuneration paid to the managerial staff under the group bonus scheme was actually a commission while the appellant argued that the same was a bonus payment and as such for the year of assessment 1975, a sum of

$319,066.50 was disallowed for deduction. In other words, the respondent disputed the applicability of section 39(1)(h) to the group bonus scheme of the managerial staff.

The question for the determination of the Special Commissioners was:

> "Whether the additional remuneration paid to the administrative staff (i.e. the managerial staff) of the appellant under the scheme is a commission and therefore deductible as an expense wholly and exclusively incurred in the production of gross income of the appellant within the meaning of section 33 of the Income Tax Act 1967; or is a bonus payment within the meaning of section 39(1)(h) of the Act and therefore be disallowed as a deductible expense beyond the limits stipulated therein."

The Special Commissioners decided that it was a bonus payment. On appeal, Harun J. disagreed and held that it was a commission. Hence the appeal."

It was conspicuously obvious that the two Supreme Court cases could easily be distinguished with the current appeal not only by

virtue of the facts but also the distinguishing factors embedded in the respective agreements. In *Director General of Inland Revenue v Harrisons & Crosfield (M) Sdn Bhd* the controversial bonus was compartmentalized under a separate and special heading; it was called *Additional Remuneration Scheme*. Under this heading selected managerial staff was entitled to participate in profits under the rules of the latter scheme. It had a discretionary quality, unlike salaries that were beyond adjustment or review on the whims and fancies of the employer (giver). The remuneration under this heading was over and above of the salary given to the selected managerial staff, and by whatever name one would call, if it were in the nature of bonus, contractual or not, if it fell under the purview of section 39(1)(h) it would be treated as bonus. In *The Director-General of Inland Revenue v Highlands Malaya Plantations Ltd* the approach of the respondent was quite similar to that of the *Director General of Inland Revenue v Harrisons & Crosfield (M) Sdn Bhd* in that the managerial staff were entitled to participate in the group bonus scheme in accordance with the standard letters of appointment. The clerical staff (i.e. the non-managerial staff) were each paid a bonus at the discretion of the respondent. The court concluded that the payment could be gratuitous as in the case of the non-managerial staff or it may be contractual payment, to which the managerial staff was entitled as incentive, but nevertheless still a bonus. It was an undeniable fact too in this case nomenclature-wise, both groups were paid from the very beginning pursuant to a scheme that carried the word ‘bonus’, and with that additional remunerations being subject to the discretion of the respondent. The case of *Saledy Sdn Bhd v*

Director general of Inland Revenue [1994] 3 CLJ 492 regretfully was of no help in our discussion as the learned judge there never at any time discussed how he arrived at the conclusion that the additional remuneration was bonus. He merely said:

> "It was agreed by both parties before the Special Commissioners that the limits imposed by s. 39(1)(h) of the Act is only applicable to employees. Since I hold that Dr. Yeo is an employee in the instant case this section therefore applies in respect of the 40% share of the profits subject to a maximum of RM100,000 per year which is clearly a bonus: *The Director-General of Inland Revenue v Highlands Malaya Plantations Ltd [1988] 2 MLJ 99*."

There was no detailed discussion on why and how the 40% of the share of the profits was declared bonus. Likewise the above case of *The Director-General of Inland Revenue v Highlands Malaya Plantations Ltd* was only mentioned in passing, without any serious discussion being undertaken.

It must be clarified in no uncertain terms that there was nothing sinister in the manner the respondent here had framed its terms here. It was merely arranging its business and financial affairs in such a way that would minimize its tax liability. This mode of tax avoidance would result in the lowest possible income tax for itself, a course of action that was rational and legal. Opposed to this is tax evasion, where taxpayers understate their taxable income or claiming fictitious

deductions, and thus illegal (*Malaysian Income Tax by Goh Chen Chuan*).

It is indisputable that there is no statutory definition of the word "bonus" in the Act. For assistance, a need arises for us to refer to other sources to arrive at the meaning of this word, and in the circumstances of this case, whether the payment to Dr. McCoy falls under it. In '*Words and Phrases Legally defined A-C (2nd Edition)* at page 176 Stirling J in Re Eddystone Marine Insurance Co. [1894] W.N 30 said:

> "I adopt the definition of bonus given in the New English Dictionary viz. a "boon or gift over the above which is normally due as remuneration to the receiver, and which is therefore, something wholly to the good."

In *Shelford v Morsey [191] 1 KB 154*, Lord Reading C.J at pg 158 and 159 said:

> "The sole question in this case is whether or not a bonus agreed to be paid to a seaman as recorded in the ship's articles is to be treated as something apart from wages…. "Bonus" in such a case as the present one is in truth nothing else but an euphemism for "additional to wages".

In *Sutton v A.G [1923] 39 T.L.R pg 294* at 297 Lord Birkenhead had said:

> "The term "bonus" may of course be properly used to describe payment made of grace and not as of right. But nevertheless may also include as here payments made because legally due, but which the parties contemplate will not continue definitely."

In *Great Western Garment Co. Ltd v Minister of National Revenue [1948] 1 D.L.R 225*, Exchequer Court of Canada, O' Conner J at 233 said:

> "Bonus is not defined by the Order but the meaning given by the Webster's International Dictionary is "Something given in addition to what is ordinarily received by or strictly due to the recipient." The Oxford Concise Dictionary defined bonus as "Something to the good, into the bargain (and as an example)…..gratuity to workman beyond their wages."

From the definitions supplied above, bonus may have certain characteristics. To start with, it is in addition to the wages paid to an employee, something that is over and above the agreed remuneration. It may be in the nature of a gift, a temporary boon or something freely given at the discretion of the giver as opposed to being an agreed normal remuneration, and includes payment which is legally due or contractually provided for.

To ensure that the terminology of bonus under discussion falls within the context of the Act, the presence of intention to make the deferred payment as part of his remuneration, and not a bonus payment, is a cogent factor, and will play an important role in the circumstances of the case. That being so, the four corners of Dr. McCoy's employment agreement must be scrutinized as a whole, and thereafter decide under what category the 25% payment falls under. To quote Finley J in *Ainley v Edens (19) T.C p 311:*

> "….of course, one has not merely to be tied to a word, one has to look at the document as a whole and arrive at a conclusion as to what the thing really is."

Dr. McCoy's employment document is contractual in nature and the company is bound by it. A simple reading of the agreement shows that the 25% payment is not at the discretion of anyone, it being part and parcel of the salary agreement, with nothing being said of percentages in relation to the salary, but rather to some deferred ascertainable profit at the end of the year. There was nothing complicated about the employment agreement and at the end of the day it was just a question of construction of the relevant document, the facts of the case and the relationship between the relevant parties.

No doubt if there is no profit then Dr. McCoy receives no additional remuneration; likewise if the yearly profit is small then he receives a small but fixed 25% payment. This 25% payment is not a large

percentage when compared with the 40% as agreed by parties in *Director-General of Inland Revenue v Highlands Malaya Plantations Ltd.* But what is pertinent and obvious is that the payment however small, is not discretionary and subject to the tender mercies of the employer, or the percentage subjected to review. It shall be paid out like any normal earning as demanded by the agreement. In contradistinction, in a company where employees do receive bonuses, not every profitable year will guarantee receipt of bonuses, as there is no obligation on the part of the employer to pay something to the employee over and above the normal remuneration.

Sifting through the evidence (Record Rayuan pages 306-308) and for comparison purposes, we were not unmindful of the income of another medical practitioner, one Dr. R. Menon for the years of assessment of 1978, 1979 and 1980, respectively at RM338,337.00, RM348,000.00 and RM377,516.00. On average he earned RM28,197.74 per month in 1978, RM29,000 per month for 1979 and RM31,458.66 per month for 1980. Compare this with Dr. McCoy's yearly RM36,000 per year or RM3,000.00 per month! It does not take much effort and time to conclude that the contractual 25% yearly payment must surely be part of Dr. McCoy's earnings. To restate our findings, read together with the salary of RM3000, which did not commensurate with a consultant's status and qualification, the deferred payment by no figment of the imagination could be termed a bonus payment. It was part of his hard-earned income, though deferred and subject to profitability, as *intended* by parties. It was also our view that, for something that was so obvious, there was no

necessity to adduce cogent evidence merely to establish that the pay of Dr. McCoy did not commensurate with his status as a consultant (as also found by the learned judge).

Based on all the above reasons we dismissed the appeal with costs.

Dated this 31st day of March 2009.

SURIYADI HALIM OMAR
Judge
Court of Appeal, Malaysia

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