SECTION 140A INCOME TAX ACT 1967

PSB
V.
DIRECTOR GENERAL OF INLAND REVENUE
(PKCP(R) 454 – 456/2018)

The Taxpayer is wholly owned by PGEO Group Sdn Bhd whereas PGEO Group Sdn Bhd is wholly owned by Wilmar International Ltd which is based in Singapore. Its principal business is an investment holding, processing and marketing of edible oil products and manufacturing of steel drums. In Year of Assessment ("YA") 2010, the Taxpayer claimed reinvestment allowance ("RA") under the category of expansion project on existing product and modernization or automation project. The claim related to the cost of factory building (Ace Solvent Fractional Plant), the cost of plant and machinery (Ace Solvent Fractionation Plant), and Neutralization Plant linked to Acetone Solvent Fractionation Plant to build a new plant. The Taxpayer reported in the tax return forms for YAs 2011 and 2014 of the sale to its related companies in Malaysia and outside Malaysia. The Director General of Inland Revenue ("DGIR") disallowed RA claim on the basis that the new plants did not amount to a qualifying project under Paragraph 8(a) Schedule 7A Income Tax Act 1967 ("ITA 1967"). The DGIR also invoked Section 140A ITA 1967 for YAs 2011 and 2014. This resulted into additional assessments raised for YAs 2010, 2011 and 2014 ("Assessments"). Dissatisfied with the Assessments raised, the Taxpayer filed notices of appeal against assessments for YAs 2010, 2011 and 2014 respectively.

The Taxpayer contended that the assessment for YA 2010 was time-barred since the DGIR failed to raise it within five years. The DGIR failed to provide reason to justify the invocation of his powers under Section 91(3) ITA 1967. The DGIR had never alleged, much less substantiated or proved any negligence on the Taxpayer's part during the audit and for the first time during the trial, alleged the Taxpayer had been guilty of negligence in claiming RA. The new plants did in fact enable the Taxpayer to manufacture an existing product i.e. Cocoa Butter Equivalent ("CBE"). The new plants led to the increase of sales or turnover in value, sales quantity, production capacity, and utilization of resources of the Taxpayer in manufacturing of CBE, hence it expanded the Taxpayer's existing business in manufacturing and sale of edible oil (including CBE). Alternatively, the new plants also fulfilled the criteria to be a qualifying diversification project. Prior year 2010, the Taxpayer imported Shea Stearin from overseas in order to manufacture CBE. Further, nothing in the ITA 1967 or in specific, Schedule 7A ITA 1967 provided that a "backward integration project" could not be a qualifying diversification project under Schedule 7A ITA 1967. The most recent Public Rulings 10/2020 and 10/2022 have also recognized that qualifying expansion projects includes backwards integration projects.

For YAs 2011 and 2014, the Taxpayer argued that no adjustment to the median was required when the Taxpayer's result was already within the inter-quartile range ("IQR") and that the median was not a good determinant of arm's length pricing. When there was comparability defect, statistical tools such as interquartile range or other percentiles were used to narrow the range of figures to enhance reliability of the analysis. There was no comparability defect as the DGIR himself selected and agreed with the selection of seven comparable companies in the present case. For YA 2014, the Taxpayer had suggested to the DGIR that weighted averages of YAs 2012 to 2014 should be adopted to analyze YA 2014 due to several economic circumstances. The Taxpayer's basis in using weighted averages of YAs 2012 to 2014 to determine its result for YA 2014 was because a year-on-year analysis i.e. YA 2014 alone was not sufficiently reliable due to several unforeseen economic and climate circumstances that occurred in YA 2014 such as El Nino phenomena and the hike in

unit price of electricity and natural gas as mentioned in paragraph 3.62 OECD Guidelines 2010. The DGIR's witness too, during trial admitted that if there was any comparability defect, an appropriate measure such as weighted averages should be used to minimize the risk of error.

In response, the DGIR argued that the Taxpayer had claimed the RA for items which were not qualified to claim. The disallowed expenditure was negligently claimed by the Taxpayer thus resulting in less chargeability of tax. If no audit was done by the DGIR, this would not have been discovered. The Taxpayer also did not submit supporting documents to show that the production of CBE was started as early as year 2008 and did not inform the DGIR during the audit that there was production of CBE before year 2010. The DGIR had discharged his burden of proof that the Taxpayer had committed negligence as envisaged by Section 91(3) ITA 1967. Therein, the DGIR's action in raising the tax after the period of five years was valid. There was no express provision in the ITA 1967 which imposed a statutory duty on the DGIR to give reasons for lifting time-bar or making any decision on tax assessment. In fact, the DGIR had given his reason in the first audit finding for rejecting the RA claim that the Taxpayer's project did not come under the category of expansion. The new plants were not a qualifying expansion and did not enable the Taxpayer to achieve expansion of an existing product as the Taxpayer had not been producing Shea Stearin before year 2010, but imported them from overseas. The Shea Stearin was a semi-finished product and did not fall within the definition of the word "qualifying project" in Paragraph 8(a) Schedule 7A ITA 1967. The Taxpayer's existing product was CBE, yet the new plants were for the production of Shea Stearin and not for CBE. Further, the Taxpayer reference to the Public Rulings 10/2020 and 10/2022 were totally irrelevant. There was nowhere stated in the Public Ruling 2/2008 that the qualifying expansion projects would include backward integration projects.

Further, the DIR had contended that the Taxpayer used the comparable companies with a comparability defect due to unavailable information on the business strategies of the comparable companies. Based on the benchmarking analysis by the DGIR, the result of the Taxpayer for YA 2011 was below the median point and for YA 2014, it was done outside the interquartile range of the comparable companies. Therefore, the transaction between the Taxpayer and its related companies was not done at arm's length. Therefore, the DGIR made the adjustment to the median point and upon consideration on the comparability defect of the comparable companies in terms of the business strategies which was a non-compliance of the comparability factors under the Transfer Pricing Rules 2012.

On 15.12.2023, Special Commissioners of Income Tax ("SCIT") held that the Taxpayer had successfully discharged its burden of proof under paragraph 13 Schedule 5 ITA 1967 in proving that the additional assessments and penalties raised by the DGIR were excessive and wrong. Therefore, the Taxpayer's appeals were allowed and the Notices of Additional Assessments for YAs 2010, 2011 and 2014 were set aside.

Editorial Notes:
The DGIR has the right to file an appeal against the decision by the SCIT within 21 days from the date of the decision.