MALAYSIA

IN THE HIGH COURT OF SABAH AND SARAWAK AT KUCHING

TAX APPEAL: KCH-14-2-2011

BETWEEN

KETUA PENGARAH HASIL DALAM NEGERI … Appellant

AND

KHIND-MISTRAL (BORNEO) SDN BHD … Respondent

AND

BETWEEN

KHIND-MISTRAL (BORNEO) SDN BHD … Appellant

AND

KETUA PENGARAH HASIL DALAM NEGERI … Respondent

BEFORE THE HONOURABLE JUSTICE
Y.A. PUAN RHODZARIAH BT. BUJANG

IN CHAMBERS

JUDGMENT

On 25.11.2010 the Special Commissioners of Income Tax have decided that incentive trips paid to the dealers of the appellant company, Khind-Mistral (Borneo) Sdn Bhd who have reached their

sales targets were expenses which are deductibles under section 33(1) of the Act. ie they were incurred in the production of the company's gross income but they came within the definition of "*entertainment*" under section 18 of the Income Tax 1967 and therefore taxable by virtue of section 39(1)(l) of the Act. However, they have also decided that the Inland Revenue Board cannot impose a penalty under section 113(2) of the Act as the company *"had made full disclosure and the expenses were clearly and correctly described"* in the Return Form submitted to the Inland Revenue Board. In other words, there was no intention to mislead the Board and to evade tax.

Both parties were unhappy with the decision and have appealed and cross-appealed against it.

The salient facts

The facts as stated by the Special Commissioners in their judgment are summarised as follows.

The company is in the business of dealing and trading in electrical products under the brand name of "Khind". It appoints dealers to sell their products and in 1996 introduced a scheme to motivate and reward dealers who have reached their sales target by giving them trips to their local factory and tourist destinations both local and abroad. These incentives are on top of the commissions and discounts given to the dealers. For the years of assessment 2000(CY), 2002 and 2003 the company had exluded all the expenses

for these trips when declaring their taxable income under section 33(1) of the Act.

Section 33(1) provides,

> "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 asertained by deducting from the gross income of that person from that source for that period all outgoings and expenses wholly and exclusively incurred during that period by that person in the production of gross income from that source, including –
>
> (a) subject to subsection (2), any sum payable for that period (or for any part of that period) by way of interest upon any money borrowed by that person and -
>
> (i) employed in that period in the production of gross income from that source; or
>
> (ii) laid out on assets used or held in that period for the production of gross income from that source;
>
> (b) rent payable for that period (or for any part of that period) by that person in respect of any land or building or part thereof occupied by him in that period for the purpose of producing gross income from that source;
>
> (c) expenses incurred during that period for the repair of premises, plant, machinery or fixtures employed in the production of gross income from that source or for the renewal, repair or alteration of any implement, utensil or article so employed, other than implements, utensils, articles (the expenditure on which would be qualifying plant expenditure for the purposes of Schedule 3) or any means of conveyance, excluding the cost of reconstructing or rebuilding –
>
> (i) any premises, buildings, structures or works of a permanent nature;
>
> (ii) any plant or machinery; or
>
> (iii) any fixtures; and
>
> (d) such other deductions as may be prescribed."

The Inland Revenue Board decided otherwise. They considered that these expenses were infact entertainment under section 18 of the Act and not allowed under section 39(1)(l). They have chosen therefore

to impose a penalty of 60% of the amount of tax which had been undercharged under section 113(2) of the Act.

Sections 18 and 39(1)(l) provide as follows:

Section 18

"entertainment" includes –

(a) the provision of food, drink, recreation or hsopitality of any kind; or

(b) the provision of accommodation or travel in connection with or for the purpose of facilitating entertainment of the kind mentioned in pargraph *(a),*

by a person or an employee of his in connection with a trade or business carried on by that person."

Section 39(1)(l) *[Prior to its admendment vide Act 631]*

"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 -

…

(l) any expenses incurred in the provision of entertainment including any sums paid to an employee of that person for the purpose of defraying expenses incurred by that employee in the provision of entertainment:

Provided that this paragraph shall not apply to the following expenses:

(i) the provision of entertainment to his employees except where such provision is incidental to the provision of entertainment for others;

(ii) the provision of entertainment by a person who carries on a business which consists of or includes the provision for payment of entertainment to clients or customers of that business and that entertainment is provided for payment by the clients or customers in the ordinary course of that business;

(iii) the provision of promotional gifts at trade fairs or trade or industrial exhibitions held outside Malaysia for the promotion of exports from Malaysia;

(iv) the provision of promotional samples of products of the business of that person;

(v) the provision of entertainment for cultural or sporting events open to members of the public, wholly to promote the business of that person; or

(vi) the provision of promotional gifts within Malaysia consisting of articles incorporating a conspicuous advertisement or logo of the business."

It is clear from the above narration of the facts that this appeal both before the Special Commissioners and now me centers on the interpretation of relevant provisions of a statute which is a time-honoured task of the court. In discharging this function it is already trite law that the court must give effect to the natural and ordinary meaning of the words. When the meanings are in doubt, only then would recourse be made to the preamble in order to understand the reasons why the legislation was enacted in the first place (see the House of Lord's case of ***Sussex Peerage (1843-60) All ER Rep. 55*** and that of the Federal Court in ***Sri Bangunan Sdn Bhd v Majlis Perbandaran Pulau Pinang & Anor [2007] 5 CLJ 673,*** both cases provided in the written submission of Inland Revenue Board's counsels). Such recourse is of course not warranted in this case, I must add.

In addition, and again, relying on and agreeing with the Inland Revenue Board's own counsels' submission, when interpreting a taxing statute, the interpretation must be strict. There is, according to Rowlatt J in ***Cape Brandy Syndicate v Inland Revenue Commissioners (1921) 1 K.B. 64***, *"no room for any intendment, no equity about tax, no presumption as to tax. Nothing, said His Lordship is to be read in, nothing is to be implied"*. This pronouncement has been adopted by the Federal Court in ***Palm Oil***

Research And Development Board & Anors v Premium Vegetable Oils Sdn Bhd [2004] 2 CLJ 265.

The Inland Revenue Board's counsels referred also to a decision of Dato' Aziah Ali J (as Her Ladyship then was) in ***Ketua Pengarah Hasil Dalam Negeri v NV Alliance Sdn Bhd (Civil Appeal No. R1-14-04-2009)*** where Her Ladyship held that payment incentives are gratuitous in nature and made without consideration and because section 18 of the Act defines '*entertainment'* to include "*hospitability of any kind"* therefore the incentives comes within the meaning of "*entertainment*".

I agree that the facts in this cited case is similar with that before me now in that the incentive trips given here were given over and above the commissions, discounts and cheaper prices to the dealers. But Ms. Chan Siew Yen submitted that ***NV Alliance's*** case should not be followed in the light of the decision of the Court of Appeal in ***Aspac Lubricants (Malaysia) Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri [2007] 5 CLJ 353***.

In the said case, Gopal Sri Ram JCA (as His Lordship then was) laid down the guideline for the interpretation of what should be construed as "*entertainment*". His Lordship said, *"… the proper approach in determining whether the expenses in respect of the customers items were incurred in the production of income, is to examine the true nature of the transaction between the appellant and its customers"*. His Lordship then proceeded to quote at length the

judgment of Romer LJ in ***Bentleys, Stokes & Lowless v Beeson (1952) Vol. 2 All ER 82*** where it was stressed that if in truth the sole object of the activity undertaken was *"business promotion, the expenditure is not disqualified because the nature of the activity necessarily involves some other result, or the attainment or furtherance of some other objective, since the latter result or objective is necessarily inherent in the act"*. This consideration His Lordship made after posing this question: Was the entertaining, the charitable subscription, the guarantee, undertaken solely for the purpose of business, that is solely with the object of promoting the business on its profit earning capacity?

Gopal Sri Ram JCA went on further to hold, and I paraphrased this in my own words, that where there is consideration moving from the customer to the appellant (taxpayer) in the form of payment for the product sold, then the expenses incurred for these promotional items or gifts for the products are not entertainment expenses under the Act. According to His Lordship these promotional gifts were *"bargains made by the appellant for the sole purpose of business promotion and hence fall within the basket provision".*

Counsels for Inland Revenue Board sought to distinguish the application of ***Aspac's*** case on the grounds that the income tax provision in ***Bentley's*** case is more akin to section 33(1) and not section 39(1)(l). He submitted that in deciding whether the expenses fall under "*entertainment*", I must not solely be guided by the consideration of whether the entertainment expenses were incurred

for the promotion of business but to the words of section 18 which says *"… in connection with a trade or business carried on by that person".*

With respect I am unable to appreciate the distinction which was sought to be made here. The undeniable fact is that the courts in both ***Bentley's*** case and ***Aspac's*** case stressed on the business promotion aspect of the expenses claimed to be deductible and that even if the said activity has some *"… connection with a trade or business carried on by that person."* The *'business promotion'* aspect of the activity is the material consideration.

Now these incentive trips were not merely given to any dealer. They were only given to those who have achieved their sales target. Achieving the sales target can mean only one thing – boosting the sales of the company's product and therefore its income. Of course the incentive trips produces another result which was a reward to the recipient for a job well done but the basic premise, or rather the only reason it was given was because the sales target had been achieved. The consideration which Gopal Sri Ram JCA spoke about in ***Aspac's*** case is also evident in this one, which is, the dealer's achievement of the sales target set by the company. Thus, in my view, the incentive trips were not "*entertainment*" within the meaning of section 18 of the Act.

For completeness, I would also like to add that I also do not think that these trips were in a nature of '*hospitality'* mentioned in

section 18 either. The company was not being hospitable within the natural and ordinary meaning of the word, '*hospitality'* explained in ***United Detergent Industries Sdn Bhd v Director General of Inland Revenue [1999] AMR 462*** which was described therein as *"the action of entertaining someone without that person having to subscribe towards the cost incurred by the host for the purpose of entertaining that someone*". This is because the dealers or recipient of the incentive trips must '*earned'* those trips. They were not given to all dealers – only to those who achieved their sales target. In other words, only to those who contributed to and had generated more income for the company.

For these reasons, I would allow the company's appeal and a fortiori, since their appeal is allowed, that of the Inland Revenue Board should be dismissed because the imposition of a penalty has become a non issue now that the said expenses are deductible.

As for costs the parties have agreed for it to be fixed at RM8,000.00 and that was also my order.

Sgd.

(Y.A. PUAN RHODZARIAH BT. BUJANG)
Judge
High Court II Kuching

Date of Judgment : 14th day of September 2011

Date of Hearing	:	16.6.2011 and 12.8.2011.
For Appellant	:	En. Ahmad Isyak bin Mohd Hassan Senior Revenue Counsel Inland Revenue Board, Malaysia Kuala Lumpur together with Wan Khairuddin bin Wan Montil Revenue Counsel Inland Revenue Board, Malaysia Kuching
For Respondent	:	Ms. Chan Siew Yan, Messrs. Ee & Lim Advocates, Kuching.