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A REVIEW OF TAX DEVELOPMENTS AND TAX CASES IN THE AREA OF NONRESIDENTS INCOME AND ISOLATED TRANSACTION

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INTRODUCTION

Revenue Law is one part of law that cannot be left to Common Law alone. This is because unlike the law of tort for example, Revenue Law is a man made law. It is a codified law where an act is provided for by the Parliament. All the provisions in the law have been formulated and provided for as detailed as possible in the statute. This is classified as civil law. And because of this we normally say that there is no equity in taxation. The equity is in the eyes of the Tax man, i.e. The Treasury Department.

However, sections in the Act will not be able to embrace all situation intended to be covered by the Act. Sections in the Act are normally drafted as general as possible to cover the wildest possible scope to meet the objectives of the provision. This normally creates ambiguity that provides loopholes to be exploited by tax planners.

The Inland Revenue Department is implementing the tax law based on the spirit of each section as intended and designed by the Treasury Department. They tend to interprete the law to the government's advantage taking into account the objectives of each provision in the law.

As taxpayers get more sophisticated, the tax law had also developed with added provision to patch loopholes and amendments to create stricter and firmer rules on each aspect of taxation. The practices and interpretation of law also developed with the cases and court decisions related to specific provision in the act. That is why taxation is said to be a fast moving subject that develops as a result of economic and environmental changes.

The basic trend in Malaysian Taxation can be observed quite clearly producing a cycle of development. It starts with an appeal by taxpayers challeging the practice and implementation of the law by the Inland Revenue. Taxpayers normally dispute the interpretation of the law by the Inland Revenue Department. This appeal will be brought to the Special Commissioners, High Court, or even Supreme Court. Assessment of the Revenue Department is normally challenged

where there is ambiguity and loopholes in the act. The court decision will determine the trend in the regulation and tax amendment. The court will normally set up a precedent on the current regulation and implementation of the law. However, in the case where the court decided for the taxpayers, normally, it will not take long before the Treasury Department comes with an added provision to amend the law to patch the loopholes.

One very clear thing in the cycle is that, the court normally are not sympathetic with the Inland Revenue Department in interpreting the law according to the spirit or intention of each specific provision in the Act. Instead, the court normally interprete the law as it was read and construed in the Act. Sometimes, poor drafting of a provision does act to the benefit of taxpayers.

If we go through the Act, we will notice sections with additional capital letters. These are actually additional sections inserted in the course of patching up these loopholes in the act. We will try to observe

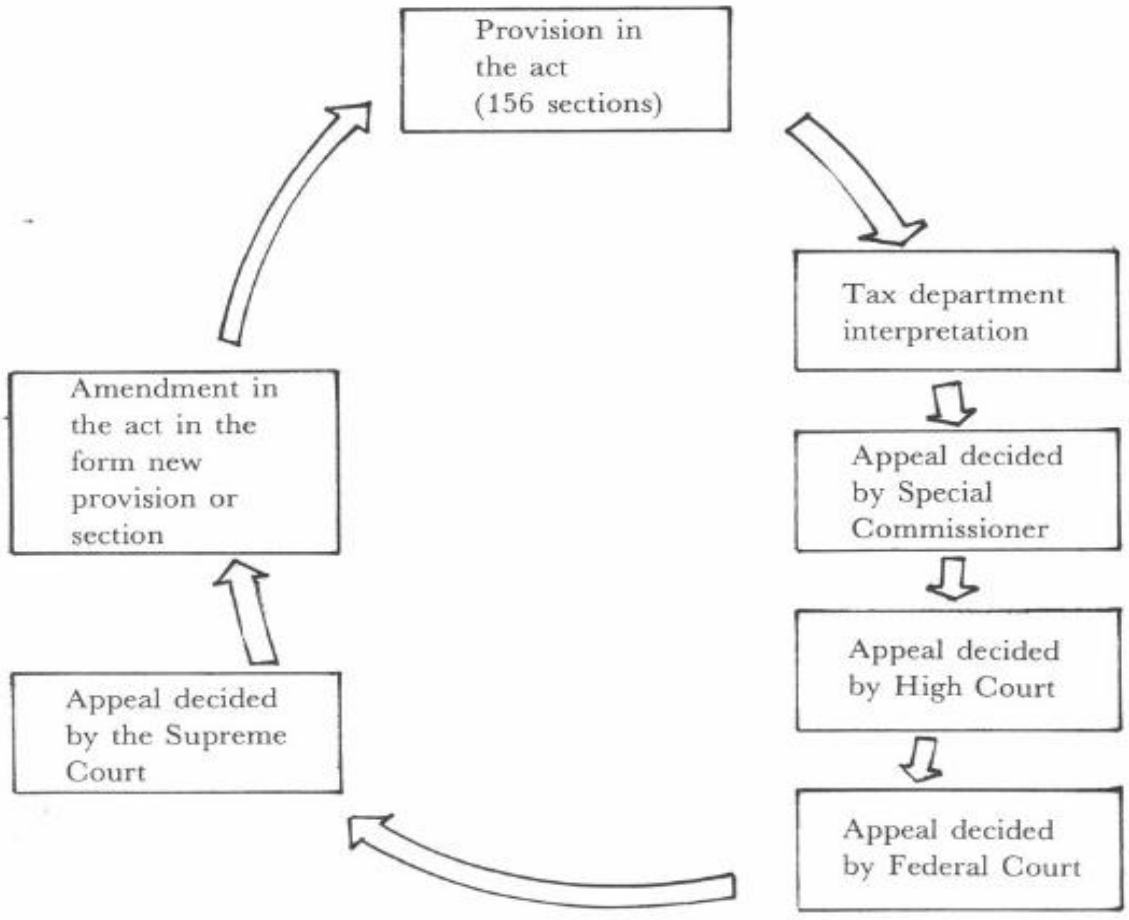

DIAGRAM 1. Developments of Tax Provision in the Malaysian Tax Law

this trend in our discussion on the tax practices and tax case development in Malaysia.

There are two areas in which we will concentrate our discussion in. Each area is related to assessment practices on different types of transaction that are most controversial and popular among taxpayers. Areas that will be covered are as follows:

- Income derived by non resident not having a permanent establishment in Malaysia; and
- Isolated transactions and the charge to tax.

INCOME DERIVED BY NON RESIDENT

GENERAL BACKGROUND

Section 3 of the Malaysian Income Tax Act, 1967 determines the charge of income tax in Malaysia.

"... income tax shall be charged for each year assessment upon the income of any person accruing in or derived from Malaysia or received in Malaysia from outside Malaysia".

Basically, income is only taxable in Malaysia, where it is accrued or derived in Malaysia except for Malaysian Residents who are also taxed on income received in Malaysia.

It is therefore important to determine when income is said to be accrued or derived in Malaysia. This is specified in the act as follows:

- Where income is not attributable to operations of business outside Malaysia, then it shall be deemed to be derived from Malaysia — *Section 12 (1)(a).*
- In the manufacturing, growing, mining, producing or harvesting business, income shall be deemed to be derived from Malaysia where the activity is conducted in Malaysia even though sales is being realised outside Malaysia — *Section 12 (1)(b).*
- Interset or royalty income is deemed to have been derived from Malaysia where:
  1/ Responsibility of payment of such interest or royalty lies with:
  - the Government or a State Government — *Section 15(a).*
  - a person who is resident in Malaysia — *Section 15 (b)(i).*

  2/ Money borrowed is employed as capital or laid on assets used, producing income in Malaysia — *Section 15 (a)(ii).*

  3/ Debt is secured by any property or assets situated in Malaysia — *Section 15 (b)(ii).*

4/ Interest and royalty is charged as an outgoing or expense in the accounts of a business carried on in Malaysia — *Section 15 (c).*

- Dividend is deemed to be derived from Malaysia where the payer company is resident in Malaysia — *Section 14 (1).*
- There is no special provision that determines the derivation of interest, pension and dividend other than that in *Section 14(1).*

DEVELOPMENT IN THE STATUTE SINCE 1947

When Income Tax was introduced in Malaysia, the basis of taxation was *territorial* whereby income of any person accruing in or derived from Malaya or received in Malaya from outside was taxed in Malaya. However, the basis of taxation was changed to *residential* or ''world wide'' basis in 1968. Under this basis, income of a person ''ordinarily resident'' in malaya from world wide was taxed in Malaya. Due to double taxation and administration problems, the basis of taxation was changed back to the ''derived'' or ''territorial basis'' in 1974. Here income was taxable where it was ''derived'', ''accrued'' or ''received in Malaysia''. However, non residents receiving income from abroad were exempted from paying tax under *Paragraph 27 of Schedule 6.*

The derivation determination for each item of income chargeable to income tax has also developed over time. We could briefly study the changes by observing the following amendments:

1973 — Section 15 has been amended by adding *subsection (c)* as follows — ''if interest or royalty is charged as an outgoing or expense on the accounts of a business carried on in Malaysia''

Section 15(c) is an amendment made based on implementation and procedural needs. This is done based on the countervailing principle to impose the burden of proof to taxpayers. It forces the taxpayers to report the income on behalf of the payee in order for them to claim a deduction.

1982 — Paragraph 33 of Schedule 6, was introduced to provide exemption from withholding tax on interest income from approved loans derived in Malaysia.

This can be considered as tax expenditure provision that provides incentives to foreign capital in the form of loans.

1983 — Section 107A, has been added to provide for regulation on withholding tax on income of non resident contractors. ''Where any person makes any contract payment to a non resident contractor in respect of services under contract, he shall upon paying or crediting such contract payments deduct therefrom tax at prescribed rate''.

This section has the same spirit and intention as *Section 109* except that it is tackling a different kind of income, i.e. services under a contract.

Services under a contract means:

- The performing or rendering of any work of professional services in Malaysia, being work or professional services in connection with or in relation to, any contract project.
- The granting, providing or supplying of the use, or the right to use, in Malaysia any personal property or any services of any person being a person other than the non resident contractor.

Professional service is defined in *section 107A(5)* to include any advisory, consultancy, technical, industrial, commercial or scientific services.

The rate of withholding is at 15% for the contractors and 5% for employees of contractors.

1984 — Section 15A has been introduced whereby rent or other payments under an agreement or arrangement for the use of any moveable property shall be deemed to be derived from Malaysia.

Section 109B — has also been added in parallel to this to impose a withholding tax on payments to non resident in respect of:

- Rental of any moveable properties
- Services in connection with the use of, or installation or operation of equipment purchased from such non residents.
- Technical advice or services in connection with technical management or administration.

All the three categories of payments have been grouped under a new charging section, i.e. *Section 4A* to which withholding tax of 25% under *Section 109B* applies.

This section not only introduces the practice of withholding tax on rental income of non residents but also exhaustively clarify the imposition of tax on rental income on moveable properties, installation charges and fees for technical advices and services related to the properties. We will observe that this section is actually a patching provision drawn after several cases related to the subject matter have gone for tax appeals. This will be shown in the following discussion on a few related cases that were decided recently.

1985 — An amendment was made in the act to abolish Development Tax and Excess Profit Tax on *Section 4A income.* This is effective from year assessment 1984.

THE DEVELOPMENT OF CASES LAW

Based on the above background, we are now ready to explore the relevant cases and discuss the development of the provisions in the act.

(a) Whether a territorial commission received on transaction not conducted in Malaya and not received in Malaya by a Malayan trader can be caught as income derived in Malaya.

RE C. (1957) S.B. XXXII

C was a company incorporated and resident in Singapore, which carried on business as motor dealer and repair. It had been appointed distributor for a number of non-Malaya suppliers and received territorial commissions in respect of vehicles, spare parts etc., intended for use in Malaya which were sold by suppliers outside Malaya to purchasers outside Malaya. The commissions were, to a large extent, not extended, not received in specie in Malaya but were utilised to purchase from suppliers goods which were imported and sold by C in Malaya. In the assessments on the company for 1955 and 1956 the Comptroller included all the territorial commissions received by C, on the grounds that the commissions constituted income which accrued in or was derived from Singapore or was received in Singapore from outside Singapore. And was chargeable to tax under *Section 10(1)* of the tax ordinance as gains or profits of the business carried on by C.

Question for Determination: Whether the income from territorial commission was accrued or derived in Singapore and was taxable in Singapore.

Held: The territorial commissions was accrued in, derived from and received in Singapore and therefore taxable.

"C performed no services and employed no capital outside Malaya and in the absence of the authority for the proposition that income could accrue in a place where no services were performed and no capital was employed, income which admitted to be trading receipts could only accrue in or be derived from Singapore".

"The commissions were received in Singapore for two reasons:

1/ C utilised the commissions standing to its credit in the books of suppliers in part payment of trading goods purchased from the suppliers.

2/ Case: *Spedding Dinga Singh & Co V C.I.T. (Punjab)*

... If the commissions represented income which accrued or was derived outside Singapore, they constituted income which was received in Singapore to the extent that they were utilised for the purchase of trading stocks brought into Singapore for sale.

The above case shows how Section 12(1)(a) would be interpreted and implemented in an assessment.

(b) Whether amount received under Know-how agreement and service agreement by a non resident contractor can be caught under the Income Tax Act, 1967.

DIRECTOR GENERAL OF INLAND REVENUE V. P.S. WORKS LTD

The appellant company was incorporated in India in 1933 with its registered office situated in Bombay engaging in the growing of sugar and manufacturing of sugar in India. In 1972, the company entered into three agreements with the Negeri Sembilan Development Corporation (NSDC) for the purpose of setting up a joint venture namely: Know-how agreement, service agreement and investment agreement.

Under the know-how agreement, the appellantt sold to the Corporation for use in Malaysia all the processes, formulae, knowledge and techical know-how which had been developed by the appellant for the establishment of a sugar cane plantation and sugar factory with restriction from transferring it to a third party. NSDC incorporated a private limited company GNS to set up the sugar cane plantation and factory in 1972 and adopted the three agreements above. In due course, the appellant delivered to GNS the technical materials and skilled personnel to supervise and implement the know-how agreement and the services agreement.

The consideration for the sale of the use of the know-how was by allotment of $1,500,000 shares in GNS to the appellant which was allotted on various dates. The allotment of 600,000 shares on September 27, 1973, was the subject matter of the appeal. This allotment of shares was recorded by the appellant as a capital receipt in the appellant's balance sheet. Under the services agreement, the appellant provided agricultural, commercial, technological, scientific and administrative assistance and expertise to GNS for the purpose of setting up the sugar cane plantation and factory. The consideration for the services was a lump sum of $600,000 that was recorded in the accounts of the appellant as a revenue receipt. The appellant company was registered as a foreign company in Malaysia in 1973 with its registered office in Seremban. The appellant was assessed to income tax and development tax on the consideration received under the service agreement for years of assessment 1974, 1975 and 1976.

Question for Determination: Whether amounts received under the know-how agreement and service agreement for 1974 – 1975 constituted income taxable in Malaysia?

Held: Both considerations under the know-how agreement and services agreement constituted royalty income and is taxable in Malaysia.

The argument being that the company has a permanent establishment in Malaysia and Malaysian tax would be imposable on the income or profits of such establishment and that include the royalty income.

The Special Commissioners initially decided that the consideration under the know-how agreement constituted royalty income and chargeable to income tax at 15% of gross value. On appeal, the High Court decided that the consideration under the agreement was a capital receipt and not a revenue receipt and therefore not taxable. On appeal by the Revenue, the Federal Court upheld the findings of the Special Commissioners.

The Special Commissioners had decided that the consideration under the technical services agreement constituted business income attributable to a permanent establishment in Malaysia. On appeal to the High Court, it was decided that consideration was business income under the Indian Order and not royalty.

Upon appeal to the Federal Court, it was decided that the consideration was royalty income not exempted from taxation in Malaysia.

(c) Whether management fees received by a non resident contractor under a service agreement can be caught as royalty income for purposes of Malaysian Income Tax Act, 1967.

E.I. LTD V. DIRECTOR GENERAL OF INLAND REVENUE

EIL was incorporated in the United Kingdom and for the purposes of Malaysian Income Tax was resident in the United Kingdom and had no permanent establishment in Malaysia. In 1973, it entered into an agreement with PASB to set up EISB in Malaysia with its registered office in Penang for the purpose of manufacturing catheters. The agreement provided inter-alia for EIL to appoint three directors to the board of EISB and for these directors and other EIL employees to provide managerial, planning, training, technical, operational, marketing and development services to EISB.

EISB padi EIL, management fees in three payments over three years amounting to about $145,000. The Inland Revenue Department taxed these amount as royalties within the definition of *Section 2* of the *Income Tax Act, 1967.*

Question for Determination: Whether the management fees paid constituted royalty and so taxable under *Section 109* or income/profit from operation.

Held: The management fees should be treated as income or profit and not as royalty. As EIL has no permanent establishment in Malaysia, the income or profit is not taxable in Malaysia.

Originally, the Special Commissioners had decided that the management fees was a royalty and was assesable under *section 4(d)*. The High Court confirmed the Special Commissioners decision. Upon an appeal to the Federal Court, it was held that the management fees was income or profit taxable in the United Kingdom only because it does not carry on business in Malaysia through a permanent establishment in Malaysia.

Notice that, *Section 4A* was introduced after this decision in 1983. This section was a measure to remedy a situation as decided in the above case. Even *Section 107A* was moving towards that direction realising the loophole in the provision.

(d) Whether rental and service fees paid to a non resident with no permanent establishment will be taxable in Malaysia.

ROBRAY OFFSHORE DRILLING CO LTD V. DIRECTOR GENERAL OF INLAND REVENUE

Appellant was incoporated in Hong Kong with registered office in Hong Kong and also resident in Hong Kong. It is carrying out offshore drilling operations and the hiring out of rigs for offshore drilling in regard to oil exploration.

For the years between 1974 – 1977, the appellant carried out business operations in Malaysia through a branch duly registered in 1974 under the Companies Act, 1965. The company was paying tax for year of assessment 1975 but paid no tax in the years of assessment 1977 and 1978 because of substantial losses. The appellant ceased operations in Malaysia in 1977 and notice of cessation of business was lodged in 1978. For years of assessment 1980 – 1982 the appellant had no place of business in Malaysia.

In 1977, the appellant entered into a technical service agreement with Tioman Drilling Co Sdn. Bhd., for purposes of obtaining technical advice and technical support services in relation to the hiring of a rig.

In 1978, the appellant entered into a charter agreement with Tioman for the charter, i.e. hiring out of the rig known as "P1" at the rate US$6,830 per day. The charter agreement was negotiated in Singapore and Hong Kong and was executed by both parties in Hong Kong.

Tioman entered into a separate agreement with Esso Production Malaysia Inc (EPMI) as subcontractor of EPMI to furnish offshore services and equipment. Tioman in turn signed the charter agreement

with the appellant to perform part of the obligation contained in the Tioman EPMI agreement.

Mobilization and de-mobilization of rig "P1" took place in Singapore where "P1" was kept. So the business of hiring was carried on outside Malaysia. Rig "P1" has a crew of about 100 men who were paid by Tioman under a manager based in Kuala Lumpur. The appellant carried on the business of hiring and Tioman carried on the business of offshore drilling.

The appellant holds 49% of the equity in Tioman. Tioman was incorporated in Malaysia in 1976 and was licensed by Petronas to carry out drilling operations in Malaysian waters. The appellant nominated a person to be a director in Tioman but there was no common director sitting on the boards of directors of both companies. All the directors meetings of the appellant were held in Hong Kong and the directors were resident in Hong Kong.

Payments under the technical service agreement were subjected to 15% withholding tax under *Section 109* for the relevant years of assessment. Payments amounted to $6,570,675. Payments were made outside Malaysia by Tioman to the appellant. Tax was levied on the payment as rental income under the charter agreement.

Question for Determination: Whether the income of the apellant for years of assessment 1980 – 1982, i.e. payments made by Tioman to them were attributable to the business of the appellant carried on outside Malaysia.

Held: Income of the appellant for the years of assessment 1980 – 1982, i.e. the payments made under the charter agreement were attributable to the business of the appellant carried on outside Malaysia in pursuant to *Section 3* read with *Section 12* of the Act and thereby not chargeable to income tax.

This case was decided in 1985 after the introduction of *Section 4A* and *Section 15A*, which was effective on October 21, 1983. Actually, the sections were added to patch the loophole identified in the case. However, the case was not covered by the new provision as it occured long before the new provision. Had the transaction occured after October 1983, it might have been immediately taxable.

CONCLUSION AND POSSIBLE TRENDS

Under the present legislation, it is quite clear that the following sources of income of non residents with no permanent establishment in Malaysia are taxable in taxation:

- Interest income *except* for approved loans
- Royalty income
- Rental income

- Management fees
- Service fees

The discussion above shows that the development of the statute has been more prominent in this area of tax on non residents. The common law or case law development had been the cause for the amendments to most of the provisions especially to patch the loopholes that existed.

The trend for the future will depend on the types of income that could escape from the present provisions and under tax avoidance schemes by taxpayers.

What other sources of income that could be earned by a non resident in Malaysia and not being covered by the Act? What about commission? Will commission paid by a Malaysian business to a non resident with no permanent establishment in Malaysia be taxable in Malaysia? Will brokerage paid by a Malaysian taxpayer be taxable on a non resident payee?

An interesting development to be considered would be the share market activities. Recently, the government focussed attention on the securities industry in Malaysia. It was found that more than 70% of the trading volume done in the Malaysian counters were conducted through Singapore. And most of the people involved in the transactions were Malaysians who had instructed brokers in Singapre to deal for them. Will this be the next target of the Revenue department?

Another interesting development in the act is the introduction of an amnesty provision to exempt 50% of commission earned in Malaysia but received outside Malaysia when brought back to Malaysia. This provision is effective from the budget day of 1985.

ISOLATED TRANSACTION OR PROFIT FROM OPERATION

Another area that is more controversial in Malaysian Taxation is the issue of isolated transaction. Under the classes of income chargeable to tax we have *Section 4(a)* that clearly classified gains or profits from a business as a class of income. This seems to be the only class of income taxable under business operation except for *Section 4(f)* unclassified gains or profits which is seldom used. Even though *Section* 2 has defined business to include "profession, vocation and trade and every manufacture, eadventure or concern in the nature of trade but excludes employment", it is very difficult to separate a business from a non business activity. This is so because business income or profits have always been distinguished from capital gains. As there are no capital gains tax in Malaysia, this makes it always favourable for taxpayers to get their transactions be classified as capital gains.

Capital gains are said to have occurred when taxpayers part with their fixed capital at a profit. To be considered a fixed capital or fixed assets, a property must be fixed in nature and used by the cmpany to produce income from operations. Where a person disposes his fixed assets only once and makes a profit out of it, he is said to have made capital gains. However, when he keeps selling his fixed assets, he becomes a trader in fixed assets and would be accruing operational income or profits that are taxable.

DEVELOPMENT IN THE STATUTE

1974 — As from 6th December 1973, tha first capital gains tax was introduced in Malaysia. However, the scope of tax were confined to transactions involving short term gains arising from disposal of land in Malaysia. This was called the *Land Speculation Tax Act 1974.*

1976 — The scope of capital gains tax was broaden with the introduction of the *Real Property Gains Tax* to replace the Land Speculation tax on the 7th November 1975. Real Property includes any land situated in Malaysia and any interest, option or other rights in or over such land. The Act does not restrict its scope to short term gains only. However, discrimination is made in the tax rate based on the holding period, with a zero rate after 6 years of holding.

1985 — The scope of capital gains tax has now covered shares transfer proceeds. Even though what is taxed is gross value, but the spirit was actually to tax gains from disposals of land through a transfer of shares in a land based company. This could be the first step towards a full capital gains tax in Malaysia. The tax is called the *Share Transfer Tax 1984.*

To discourage an avoidance scheme using capital gains by corporations, in 1985 the tax rate on Real Property Gain Tax had also been changed by retaining a 5% through out a disposal after the 6th year. This had actually made Real property Gains Tax a permanent tax and not a speculative avoidance tax anymore.

Even though capital gains tax has been introduced in the statute, taxpayers still consider realising capital gains as more advantages to them especially where disposals takes place after one year of holding. This is because the tax rate decreases over time. As a results, we have a lot of appeals in this area of taxation. More than 30 cases on the isolated transaction had been reported and the judgement varies with facts and situation.

It is difficult to come up with a rule of thumb as to what constitutes a trade or a business and what is not. This can be shown by the following judgement in various cases since 1947.

(a) Whether instalment payments for a transfer of agencies based on the future commission constitute income or capital receipts.

RE X (1950)

The appellant transferred certain agencies to C Ltd with a consideration being payments to him all the fees earned by the company from such agencies over a period of six years. It was held to be a transaction in the nature of a trade and therefore taxable. However Lord Justice Romers dictum in the case is worth mentioning:

"... or he can sell his property to the purchaser for £10,000, the £10,000 to be paid by an equal instalment of £500 over the next twenty years. If he adopts this method then the sum of £500 received by him each year is exigable to income tax".

The case shows how the wording of an agreement is of great importance in a decision on taxability of a transaction. Lord Justice Romers dictum can be a very important tool for tax planners. It actually provides a scope for taxpayers to plan their tax afairs by receiving instalment payments rather than income.

(b) Whether proceeds from sale of properties after renting them constitute income or capital receipts.

RE S LTD (1952)

A company took over certain partially completed properties owned by a building contractor. The company completed the construction in 1941 and let them to various tenants until 1947 when they sold them at a profit. It was held that the transactions were only realisation of assets and not carrying on a business.

This is another area where taxpayers can plan their investment and business dealing. The important difference between this case and most of the other cases is that, in this case the company had not dealt in land and the properties have been rented out for 6 years before they were sold.

(c) Whether proceeds from selling of graveyards constitute income or capital receipts.

RE A.B. LTD (1957)

A company incorporated in Singapore had been operating a rubber estates in Singapore and Johore since 1934. After the liberation, its directors decided that some 270 acres on the Singapore estate should be used as a cemetery as it was no longer profitable for rubber growing.

The company had prepared for the subdivision of one acre, and later nine acres into burial plots and proceeded to construct access roads, a temple, a tiffin shed and quarters for a caretaker.

Burial plots were not sold. A.B. merely granted burial rights in perpetuity in return for a fixed payment. Substantial sums were received from the sale of burial rights in the five years ended 1952.

A.B. was assesed under *section 10(1)(a)* on the basis that it was carrying on the cemetary undertaking. The company appealed.

Held: (Court of Appeal) — Income was taxable as a business source.

Justice Whitton, referred the case of *Edinburgh Sourthen Cemetery Co. vs. Kinmount 2 T.C. 516,* where a joint stock company was formed with object of providing accomodation for the intenment of the dead. It was held that the company was assessable for income tax in respect of receipts for inter alia, ground sold for burial purposes.

''In my opinion when a person habitually does and contracts to do a thing capable of producing profit and for the purpose of producing profit, he carries on a trade or business''.

It was decided also that deduction could not be allowed for market cost of the purchase of the land used as burial ground under section 14 of the ordinance.

(d) Whether proceeds from a sale of property constitute income or capital receipts.

D.E.F. V. COMPUTROLLER OF INCOME TAX (1961)

In 1955 J purchased part of a rubber estate for the sum of $245,000 using borrowed money from his brother (interest free). J sold it 18 days later for $485,000 to an estate development company formed in the same year in which his wife and brother were shareholders.

J was assessed on $240,000 in respect of the profit on sale of land on the grounds that the profit constituted gains or profits from the carrying on of a trade or business. J appealed contending that the profit was derived from an isolated transaction.

Held: (Court of Appeal) — Income not taxable as it was merely a capital gains.

Buttrose J, referred the case of *Martin vs Cowry II T.C. 297 and Pickford vs Quirhe (1927)13 T.C. 251* and said it is quite clear that this lone transaction did not constitute a trade using principles in the above two cases'.

''He also referred the case of *Learning vs Jones* which established four conditions to show evidence of adventure in the nature of trade namely:

1/ The existence of an organization.
2/ Activities which lead to the maturing of the asset to be sold.
3/ The existence of special skill, opportunities in connection with the article dealt with or

4/ The fact that the nature of the asset itself should lend itself to commercial transaction.

All the above criteria has not been found in this case. "Buttrose J. had also held that the term business as used in *Section 10(1)(a)* does not apply to one isolated act: it does not mean a business transaction".

COMPTROLLER OF INCOME TAX V. Q.R.S. (1961)

Q.R.S.'s wife purchased an area of freehold land in 1937 and in the same year obtained the approval of the Singapore Improvement Trust for a proposed sub-division of the land into 23 building lots with appropriate access roads. In 1939 and 1940 two pieces of the land were sold but ano development took place until October 1949. Construction work started on the construction of 15 houses. All except 3 of the 15 houses were started in 1949, and houses were sold in 1950 and 1951. The Comptroller made assessments on Q.R.S. for 1950 and 1951 on the basis that Q.R.S. was carrying on a trade or business, the profits of which were chargeable to tax under *Section 10(1)(a)* of the *Income Tax Ordinance, 1947.* In computing those assessments they gave a deduction for the cost of the land utilised for the houses which had been sold. Q.R.S. appealed. Alternatively, he sought a deduction for the market value and not the cost price of the land on which houses has been built and sold.

On behalf of Q.R.S. it was contended that the sale of the land represented the realisation of an investment by instalments. Since it was purchased in 1937 the land had been used as a rambutan orchard for the production of income, and in selling lots with houses erected thereon Q.R.S. was merely carrying out his original intention of disposing to the best advantage of those plots which he did not wish to retain. Q.R.S. never had any intention of engaging in the business of buying land for sale, proof of which was to be found in the fact that no further land was purchases after 1937:

If, however, the Board held that Q.R.S. had carried on a trade on business, it was contended that, deduction should be allowed in computing the gains or profits for the market value of the land at the date on which development commenced and not the cost price of the land at the original date of purchase 1937.

On behalf of the Comptroller it was stated that there was a clear intention to develop the land from the outset in 1937, as evidenced by the plan approved by the Singapore Improvement Trust and by statements made by Q.R.S. in correspondence with the Comptroller to the effect that the development of the land by constructing houses on it would make the land more readily marketable. The construc-

tion and sale of 12 houses in the period of less than 2 years clearly indicated that Q.R.S. had no intention to retain the houses as an investment and in selling the house almost immediately after completion, Q.R.S. had done precisely what a commerical builder would have done whose business it was to build and sell houses. No single factor was sufficeint in itself to prove the existence of a trade or business but where one found, as in the case of Q.R.S. an original intention to develop the land, a number of similar transactions carried out in a short space of time, activities designed to alter the character of the assets with a view to making it more readily marketable, and only a short interval between the adaptation and sale of a marketable commodity such as land, the evidence in favour of the Comptroller's contention that Q.R.S. had carried on a trade or business was irrefutable.

On the question of the deduction to be allowed for the land sold, it was submitted that, on the authority of the decision in *C.I.R. v. Cock Russell & Co. Ltd. 19 T.C. 387* and in *the case of C.F.* heard by the Board on 21st June 1951, the Comptroller had correctly computed the gains or profits by allowing a deduction for the cost of the land — i.e. the original cost in 1937 plus all subsequent costs of development and that the assessment should be confirmed.

Held: The Board decided that Q.R.S. was carrying on a trade or business and that the value of the land should be taken at the market value at 1.1.48. The land must be considered as a trading stock in accordance with ordinary commercial principle. It should be valued at its cost or market value which ever is the lower.

E. V. COMPTROLLER OF INLAND REVENUE (1970)

The appellant had purchased, jointly with four other persons, a rubber estate near Seremban for the price of $197,837.60. The co-purchasers of the estate had then negotiated for the sale of the estate to a company; one of whose objects was the development of land into housing sites. The estate was eventually transferred to the Company in consideration of the Company issuing fully paid up shares to the value of $765,000. For his share in the estate the appellant became entitled to shares to the value of $382,500. The Comptroller of Income Tax assessed the appellant to additional assessment in respect of the amount representing the excess of the value of the shares in the company to which the appellant became entitled over the amount of his share of the purchase price of the land, on the basis that this amount represented profit from business chargeable to income tax under *Section 10(i)(a)* of the *Income Tax Ordinancce, 1947.* The appellant appealed against this additional assessment to the Special Commis-

sioners of Income Tax but his appeal was dismissed. He then appealed to the High Court and again he was unsuccessful. He then appealed to the Federal Court.

Held: The transaction by the appellant in this case was an isolated transaction and although it was an adventure in the nature of trade, it did not constitute a trade of the appellant within the meaning of *Section 10(i)(a)* of the Income Tax Ordinance 1947. As it was a single business transaction carried out by the appellant and not part of a business carried on by him, it did not constitute the business of the appellant within the meaning of that Section. The profit arising there from is not subject to tax under the section and the appeal must be allowed.

EE FINANCE CO V. COMPLTROLLER OF INCOME TAX (1970)

EE Finance, a wholy-owned subsidiary of a bank, engaged in business as a finance company. On May 1963, it bought a piece of land of over 166 acres at a cost of $2,850,000. On September 1963, it sold the land to a property development company at $5,316,000. The Comptroller of Income Tax, assessed the resulting profit as income taxable under the Income Tax Ordinance (Cap. 166). The appellant contended that it was purely a hire-purchase company; that the purchase of the land was for the purpose of building houses to rent to the public and was therefore an investment, and, that the land was sold because the intention was frustrated and therefore the profits from the sale of the land was capital appreciation and not profits liable to tax under the Ordinance. It was also argued that as the purchase and sale of the land was an isolated transaction, it was not the business of the appellant.

Held: 1/ On the facts, during the relevant period, the appellant was not solely engaged in hire-purchase business but was more actively engaged in other sources of business:

2/ the appellant had not proved: (a) it purchased the land with the sole or dominant intention of holding the land as an investment and (b) it sold the land because its intention was frustrated. The land was sold to make a profit;

3/ the stock-in-trade of the appellant, as a finance company, was its monies and, therefore, though the purchase and sale of land was an isolated transaction, the buying and selling of the land were an integral part of the business of the appellant company, of using its stock-in-trade to make a profit for its shareholders. The profit was therefore a trading profit and was taxable.

(e) Whether proceeds from the sale of rubber land after tapping them for several years constitute income or capital receipts.

L.K.C. V. COMPTROLLER GENERAL OF INLAND REVENUE (1973)

A rubber holder and rubber tapper bought certain rubber land in 1960 – 1963 and tapped on the land. In 1966 he sold 15 lots of the land in various transactions and made a profit of $107,957. Subsequently, he bought three portions of a rubber estate in Penang. He was assessed on the profit on the transactions. On appeal to the High Court, it was held that the sale was a sale of capital assets and the difference in price was an appreciation in capital and was not taxable.

This case could also be distinguished from the other in that the taxpayers had not dealt in land before and after the transaction and the period of holding was quite long.

(f) Whether an exchange of properties with shares constituted income from trade or business.

I. INVESTMENT LTD V. COMPTROLLER GENERAL OF INLAND REVENUE (1973)

A company had acquired certain land and constructed a building on them. Subsequently, it agreed to sell the land and building to another company in exchange for shares in the company at a value above the purchase costs of the land and building. It was held that although there was only one transaction, it was carried on with the intention of dealing with properties and therefore is a profit from trade or business.

The judgement in the case was quite contrary to the belief that when one realises profit through a share transfer, one could escape from income tax which was the reason why the Shares Transfer Tax was introduced.

(g) Whether the transfer of land from fixed assets to stock in trade at market value should be subjected to income tax.

DIRECTOR GENERAL OF INLAND REVENUE V. L.C.W. (1975)

The respondent purchased a piece of land for $20,000 in 1953 with the intention of constructing flats thereon for renting as an investment. The land was shown in the fixed assets accounts. In 1967, the said land was transferred from fixed assets account to trading account at $480,000, being the market value in 1963.

Question for Determination: Whether in ascertaining the adjusted income of the respondent from his business for the year of assess-

ment 1968, the value of the stock in trade consisting the said land should be its original purchase price of $20,000 or $480,000 which was the market value when the respondent submitted plans for construction of the flats at the beginning of 1963.

Held: The cost of the land in relation to the business in this case was the value of the land at the time of appropiration to the business in 1963 and not the original value in 1953. The land should therefore be valued as stock in trade at $480,000.

This is another case where taxpayers, especially a development company could plan their tax by transfering land from fixed assets to stock in trade when they get matured (after 6 years).

(h) Whether proceeds from sale of shares constitute income or capital receipts and whether losses in a foreign branch can be offsetted against income of a local business.

U.N. FINANCE BHD. V. DIRECTOR GENERAL OF INLAND REVENUE (1975)

In this case, the appellants were a company whose objects inter alia were the accumulation of capital by means of monthly subscriptions or otherwise and also by borrowing money from members, depositors and others. They also had powers to acquire moveable and immoveable properties by way of investment, with a view to resale. The appellants bought and sold shares in a number of companies and in respect of the sale of some shares they made a profit on which they were assessed to tax.

They contended that the purchasing of shares was made as a long term investment and the profits made were capital in nature being realization of capital investments. The appellants incurred losses through their branch in Singapore and sought to have these losses taken into account in arriving at their chargeable income. The Special Commissioners held that the profits realized by the appellants for the sale of their shares were assessable to tax and they also held that the appellants were entitled to deduct their trading losses in Singapore from their income derived in Malaysia. The appellants appealed and the Director-General of Inland Revenue counter-appealed.

Held: 1/ the Special Commissoners in this case were justified in the facts in arriving at a decision that the appellants were carrying on a business of dealing in shares as an adventure or concern in the nature of trade and therefore the profits from the sale of the shares in question were assessable to tax;

2/ the Special Commissioners had erred in law in arriving at the decision that the losses of the Singapore branch attributable to a business carried out in Singapore should be deducted from their income derived in Malaysia in the ascertainment of the appellants' total income for the year of assessment 1968.

Implications that can be made from the decisions are as follows:

1/ Proceeds from dealing in shares constitute income from a business i.e. adventure or concern in the nature of trade.
2/ Losses of a foreign branch cannot be offsetted against income from a local business.

The second part of the judgement in the case was a very important precedent that must be borne in mind by taxpayers having branches in a foreign country. This hould be an important factor to be considered in their tax planning.

(i) Whether proceeds from the government's compensation on a forced acquisition of land could be subjected to income tax.

F HOUSING SDN BHD V. DIRECTOR GENERAL (OF INLAND REVENUE (1976))

Land belonging to the appellant had been acquired by the Government. Compensation in the sum of $1,407,139 was paid to the appellant and tax was assessed on the difference between the compensation and the cost of the land.

Question for Determination: Whether the difference between the compensation awarded and the purchase price was assessable to income tax under *section 4(a)*.

Held: The isolated transaction, although it concerned compulsory acquisition, should lawfully be regarded as a trading transaction and the difference between the compensation and the purchase price was income in respect of gains of profits from a business within the meaning of *section 4(a)*.

This case is very contradicting with the *1983* and *1984* amendment to the *Real Property Gains Tax Act* whereby, Real Property Gains Tax is exempted on gains where properties had to be sold to settle estate duty. The justifiable principle should be when one is forced to sell his property because of acquisition, law suit or to settle debts, the transaction should not be considered as a trade or business. Catching the transaction under the Real Property Gains Tax is bad enough what more under Income Tax Act.

(j) Whether proceeds from a sale of a land proposed for a factory/godown sold together with some other properties constitute income or capital receipts.

KOTA KINABALU INDUSTRIES SDN. BHD. V. DIRECTOR GENERAL (OF INLAND REVENUE (1981))

The appellant company was incorporated to have the members of a family in one company and to build houses on vacant properties to let out for rent. The appellant held a number of properties and some of these were sold for profits. The appellant was assessed to tax in respect of the sale of (a) a vacant lot bought for the construction of a factory/godown but sold when it was found unsuitable for the purpose; (b) and (c) two lots of rubber land and (d) a shop-lot.

The Special Commissioners held that the gain or realization from the sale of the vacant lot was a realization of a part of its investment and therefore not liable to tax. They considered the sales of the other three items as adventures in the nature of trade and therefore the profits were liable to tax. On appeal, it was dismissed by the High Court. The appellant appealed.

Held: 1/ the Special Commissioners were entitled to find out the evidence that the appellant had engaged in a trade of dealing in land;

2/ the power of the High Court to hear appeals from the Special Commissioners is to review the decision of the Commissioners on points of law being bound by the facts which they have found, provided always there is evidence on which they came to such conclusions of facts;

3/ in this case the learned Judge found no ground to interfere with the decision of the Special Commissioners and the appeal should be dismissed.

This case is quite special in that even though the taxpayers had deals in other properties and land in about the same time which make the transactions not isolated, the court still singled out the proposed factory land as an isolated transaction. In this decision, intention were considered more fundamental than actual actions.

Unlike the first area discussed above, in the isolated transaction, the development of cases were more prominent. Taxpayers were more daring and cases brought in were more varied. If we take case decision as precedent for future practices in the tax law, we notice that the development of tax law has been quite advanced in this area. I see this as an area where Common Law prevailed and create precedents in the law. The probable reasons for this development is because the provision in the Act had been very vague and it had created a lot of ambiguity.

CONCLUSION AND COMMENTS

The above discussion reviewed the tax development and tax cases in Malaysia. It is of course beyond the scope of this paper to discuss

all cases on the subject areas that have been brought to the court. Cases selected were those thought to be relevent and of interest especially where they have created precedent for tax practices in Malaysia.

As apparent cases development had played a major role in determining tax practices in Malaysia. However, the use of these cases in practice must be made with caution as some precedent in a case become redundant when the statute had been amended. This is a normal phenomenon in the Malaysian tax development whereby cases have been used as a source for statute development. Added provisions are normally included in the statute to patch loopholes identified in a case decision.

This has been the drawback of having Civil Law, for development of cases sometimes become irrelevant by the changes in a statute. However, we are not as unlucky as the British which change their Tax Statute every time there is a change in the government. So they have two set of cases each relevant to each set of tax statute.