



High Court Rules Interest From Instalment Sales As Business Income Under Section 4(a) Of The ITA

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Recently, the High Court in *CMSB v KPHDN* delivered an important ruling on the tax treatment of interest income arising from instalment sales. The Court held that such charges should be treated as business income under Section 4(a) of the Income Tax Act 1967 (ITA) rather than as interest income under Section 4(c).

The dispute centred on the proper interpretation of Section 24(5) of the ITA, in particular whether the two limbs of the provision operate disjunctively and how the phrase “debenture, mortgage or other source” should be interpreted. The decision is significant for businesses that offer instalment or credit payment schemes as part of their commercial operations, as it illustrates how the classification of income under the ITA may depend on the interpretation of statutory provisions governing interest and business income.

The taxpayer was successfully represented by our firm’s Tax, SST & Customs Partner, S. Saravana Kumar together with tax associate, Tan Jass Key.

Brief Facts

The taxpayer was principally engaged in the retail sale of electrical and electronic appliances, as well as household furniture and fittings.

As part of its business model, customers were allowed to purchase products either by cash payment or through instalment schemes. Customers who chose to pay in cash were not subject to any additional charges.

However, customers who opted for instalment payments were required to make monthly payments over an agreed tenure, together with interest, which effectively represented the cost of deferred payment.

Notably, the purchase price of the goods and the interest income were recorded separately in the taxpayer's accounting records and audited financial statements.

The Inland Revenue Board (IRB) took the position that the interest income constituted interest income, which should be taxed separately rather than treated as part of the taxpayer's business income arising from its retail operations. The taxpayer disputed this characterisation, maintaining that the interest income arose directly from its ordinary trading activities and should therefore be taxed as business income under Section 4(a).

Despite the taxpayer's explanations, the IRB issued notices of additional assessments together with penalty under Section 113(2) of the ITA. Aggrieved by the assessments, the taxpayer filed appeals before the Special Commissioners of Income Tax (SCIT).

Decision Of The SCIT

The Special Commissioners of Income Tax (SCIT) ruled in favour of the IRB based on the following grounds:

- (a) The phrase "other source" in Section 24(5) should be interpreted using the *ejusdem generis* principle, meaning that the phrase must be read within the same class as the specific terms "debenture" and "mortgage".
- (b) These terms refer to debt instruments commonly associated with lending activities. As the taxpayer was not engaged in a licensed money-lending business, the SCIT concluded that the instalment scheme did not fall within the scope of Section 24(5).

Accordingly, the SCIT held that the interest income should be subjected to Section 4(c) rather than Section 4(a), which led to the present appeal before the High Court.

Issue Before The High Court

The sole issue before the High Court was whether the interest income arising from the taxpayer's instalment scheme should be taxed as business income under Section 4(a) or interest income under Section 4(c) of the ITA?

The Taxpayer's Contentions

The taxpayer challenged the SCIT's interpretation and advanced several arguments before the High Court:

(a) Historical Treatment of Interest Income

The taxpayer first highlighted the historical treatment of the income in question. Prior to 2013, the IRB had consistently treated all interest arising from the instalment scheme as business income under Section 4(a).

However, following amendments introduced through the Finance Act 2013, the IRB changed its position and recharacterised the same income as interest income under Section 4(c).

The taxpayer submitted that the amendment only affected one limb of Section 24(5), namely loans granted in the course of a licensed money-lending business. The amendment did not affect the first limb, which relates to situations where the debenture, mortgage or other source forms part of the stock-in-trade of a business.

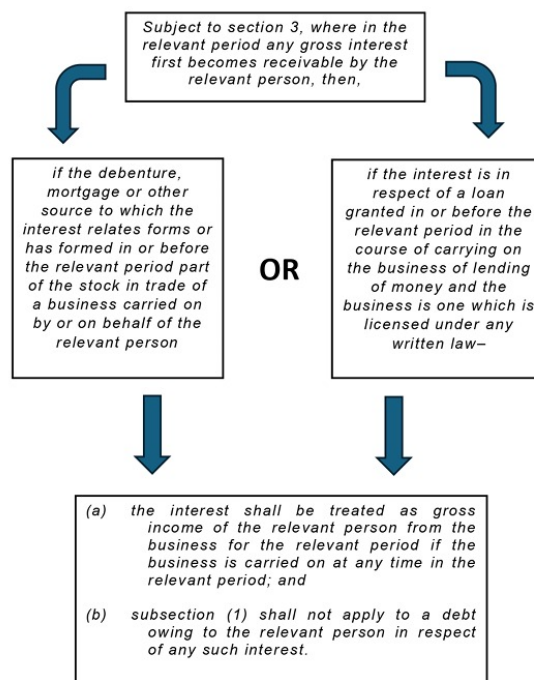
Accordingly, the taxpayer argued that the amendment did not alter the applicable tax treatment of the instalment scheme.

(b) Proper Interpretation of Section 24(5)

The taxpayer further contended that the SCIT had misinterpreted Section 24(5).

Section 4B of the ITA provides that only interest falling within Section 24(5) may be treated as business income. The taxpayer submitted that the SCIT's approach failed to properly consider the structure of Section 24(5).

For the purposes of clarity, Section 24(5) of the ITA is illustrated in the following diagram:



In particular, the SCIT concluded that the provision did not apply because the taxpayer did not hold a money-lending licence and was not engaged in a money-lending business.

According to the taxpayer, this interpretation failed to give proper effect to the structure of Section 24(5), which contained two distinct limbs connected by the word “or”. The use of the word “or” clearly indicated that the provision operated disjunctively, meaning that a taxpayer only needed to satisfy one of the two limbs, not both. The SCIT therefore erred in treating the provision as though it applied only to money-lending businesses.

(c) Incorrect application of the *ejusdem generis* principle

The taxpayer also argued that the SCIT had misapplied the *ejusdem generis* rule of statutory interpretation.

The SCIT had interpreted the phrase “other source” narrowly by limiting it to arrangements similar to traditional lending instruments. The taxpayer submitted that this interpretation was overly restrictive. When properly applied, the principle should allow the phrase “other source” to include arrangements that share common characteristics with debentures and mortgages, namely obligations involving repayment over time with interest.

Viewed in this context, the taxpayer argued that its instalment scheme possessed the same fundamental characteristics. Under the scheme, goods were supplied upfront, payment was deferred over an agreed period, and interest were imposed as consideration for the deferred payment.

Accordingly, the taxpayer submitted that the scheme fell within the meaning of “other source” under Section 24(5).

(d) The instalment scheme forms part of the taxpayer’s business

Finally, the taxpayer emphasised that the instalment scheme was integral to its retail operations.

The taxpayer’s stock-in-trade consisted of furniture, electrical appliances and related products sold to customers. In practice, a substantial portion of the taxpayer’s business was conducted through instalment arrangements. Evidence showed that approximately 70% of the taxpayer’s sales were credit-based, with customers paying for their purchases through instalment payments that included interest.

The interest therefore arose directly from the sale of the taxpayer’s products and were intrinsically linked to its trading activities.

In these circumstances, the taxpayer submitted that the instalment receivables formed part of its stock-in-trade business activities, and the related interest income should therefore be treated as business income.

The IRB's Contentions

Before the High Court, the IRB maintained that the interest income should be taxed under Section 4(c). The IRB argued that the taxpayer was not engaged in a money-lending business and did not issue debentures or mortgages. As such, the instalment scheme could only fall within Section 24(5) if it qualified as "other source".

Applying the *ejusdem generis* principle, the IRB contended that the phrase must be interpreted in light of the specific words preceding it, namely "debenture" and "mortgage". These terms referred to financial instruments commonly associated with lending activities, which differed in nature from the taxpayer's instalment sales arrangement.

Accordingly, the IRB maintained that the interest income did not fall within Section 24(5) and should instead be taxed under Section 4(c).

The High Court's Decision

After considering the parties' submissions, the High Court allowed the taxpayer's appeal and set aside the SCIT's decision. The grounds of judgment have not been issued to date.

Commentary

This decision highlights the importance of careful statutory interpretation in tax disputes, particularly where legislative provisions contain multiple limbs or alternative conditions.

The case also illustrates that income arising from commercial arrangements embedded within a taxpayer's business model may still be treated as business income, even where the income includes elements resembling interest.

For businesses that offer instalment payment schemes or credit facilities, the case serves as a useful reminder that the tax treatment of such income will depend on how closely the arrangement is connected to the taxpayer's core trading activities, as well as the proper interpretation of the relevant provisions of the ITA.

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