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High Court Rules Banking Software Costs Eligible For Capital Allowances

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The High Court has delivered an important decision for businesses investing in digital transformation, confirming that expenditure incurred on the development, customisation and upgrading of banking software may qualify for both capital allowance (CA) and accelerated capital allowance (ACA) under Schedule 3 of the Income Tax Act 1967 (ITA).

In dismissing the Inland Revenue Board's (IRB) appeal, the High Court in Ketua Pengarah Hasil Dalam Negeri v M Bank upheld the decision of the Special Commissioners of Income Tax (SCIT) in favour of the taxpayer, reaffirming that software development and implementation costs, where incurred to make software operational for business use, form part of the qualifying plant expenditure under Schedule 3 of the ITA.

This ruling recognises the commercial reality that software development, customisation and upgrading costs form an integral part of making enterprise software operational.

The taxpayer was successfully represented by RDS Tax, SST & Customs Partner, S. Saravana Kumar, together with Senior Associate, Nur Hanina Mohd Azham.

The Dispute

The dispute concerned whether expenditure incurred by the taxpayer in developing, customising and upgrading its banking systems, software systems and software packages qualified for CA and ACA under Schedule 3 of the ITA.

In the years of assessment 2014 to 2017, the taxpayer claimed CA and ACA on expenditure relating to the acquisition, licensing, development, customisation and subsequent upgrading of its banking software.

Following a tax audit, the IRB disallowed, among others:

- ACA on software upgrading costs
- CA and ACA on customised software development costs

The IRB took the position that only software acquisition costs and, where applicable, initial software licence fees qualified for capital allowances, whereas development, consultancy, licensing and upgrading costs constituted separate categories of expenditure that did not qualify under the ITA or the relevant subsidiary legislation. Additional assessments were subsequently raised, prompting the taxpayer to appeal to the SCIT.

SCIT Decides In Favour Of The Taxpayer

The SCIT allowed the taxpayer's appeal, holding that:

- the banking software constituted qualifying plant under Schedule 3 of the ITA.
- the costs of developing, customising and upgrading the software were necessary expenditure incidental to providing that plant.
- Public Ruling No. 12/2014 merely reflected the IRB's interpretation of the law and could not impose additional statutory requirements.
- the taxpayer was not required to segregate software acquisition costs from development and upgrading costs.

Dissatisfied with the SCIT’s decision, the IRB appealed to the High Court.

High Court Affirms Broad Interpretation Of Qualifying Plant Expenditure

The High Court dismissed the IRB's appeal and affirmed the SCIT's decision in its entirety.

A central issue before the court was whether expenditure incurred on developing, customising and upgrading computer software formed part of the qualifying plant expenditure under Schedule 3.

The High Court agreed with the SCIT that the taxpayer's banking systems, software systems and software packages constituted plant for the purposes of Schedule 3. More importantly, the court held that expenditure incurred to develop, customise and upgrade the software could not be viewed in isolation from the software itself. Such expenditure was necessary to make the software operational and fit for the taxpayer's business requirements and therefore formed part of the capital expenditure incurred in providing the qualifying plant.

In doing so, the court recognised the commercial reality that enterprise software is seldom acquired as an "off-the-shelf" product and often requires extensive implementation, integration and enhancement before it can be effectively deployed.

The ACA Rules Prescribe Rates, Not Eligibility

The IRB further argued that software development and upgrading costs could not qualify for ACA because they were not expressly listed in the relevant Income Tax (Accelerated Capital Allowance) Rules.

The High Court rejected this argument, holding that the Rules merely prescribe the applicable rate of capital allowance or accelerated capital allowance for qualifying expenditure. Whether expenditure qualifies as qualifying plant expenditure remains governed by Schedule 3 of the ITA.

Accordingly, the absence of an express reference to software development or upgrading costs in the Rules does not preclude such expenditure from qualifying for CA or ACA where the statutory requirements under Schedule 3 are otherwise satisfied.

Public Rulings Cannot Restrict Statutory Relief

The High Court also rejected the IRB's reliance on Public Ruling No. 12/2014, which required taxpayers to segregate software acquisition costs from development and upgrading costs.

Affirming the SCIT's reasoning, the court held that a Public Ruling merely represents the IRB's interpretation of the law and cannot impose additional conditions or narrow the statutory relief provided under Schedule 3 of the ITA.

Why This Decision Matters

The decision is an important development for businesses investing in enterprise software and digital transformation initiatives.

Modern software solutions rarely function without substantial expenditure on implementation, customisation, integration, testing and ongoing enhancement. The High Court recognised that these costs are often inseparable from the software itself and should not be artificially excluded when determining entitlement to capital allowances.

Equally significant is the Court's clarification of the relationship between Schedule 3 of the ITA and the subsidiary legislation made under Section 154(1). The judgment confirms that the Rules prescribe only the applicable rate of allowance and do not determine whether expenditure qualifies as qualifying plant expenditure in the first place.

That question must always be determined by reference to Schedule 3 of the ITA.

This decision also reinforces the well-established principle that Public Rulings cannot override or restrict the scope of relief conferred by Parliament. Administrative guidance cannot impose additional conditions that are not found in the legislation.

For taxpayers investing heavily in technology, digital infrastructure and enterprise software, the judgment provides welcome certainty when structuring capital expenditure and defending capital allowance claims during tax audits. It also serves as an important reminder that capital allowance provisions should be interpreted in a manner that reflects the commercial realities of modern business operations.

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