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Tax Deduction For Bumiputera Unit Release Fee

ST v Ketua Pengarah Hasil Dalam Negeri (High Court)

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On 22.9.2020, the High Court allowed the taxpayer's appeal to deduct the Bumiputera Unit Release Fee incurred by the taxpayer under Section 33(1) of the Income Tax Act 1967 (ITA). The taxpayer was successfully represented by our Tax, SST & Customs Partner, S. Saravana Kumar together with associate, Nur Amira binti Ahmad Azhar.

This alert summarises the facts of the appeal and the arguments advanced by both the taxpayer and the Inland Revenue Board (IRB).

Background Facts

The taxpayer is a property developer in Selangor. The taxpayer entered into an agreement with the Selangor State Government where they agreed to allocate a percentage of the shop lot units constructed to be purchased by Bumiputera buyers only. Despite numerous attempts made to sell the allocated Bumiputera shop lot units, the taxpayer was unable to sell them. Accordingly, as provided in the agreement with the State Government, the taxpayer made a cash contribution to the State Government for the release of the shop lot units allocated for Bumiputera buyers. The taxpayer sought for the cash contribution to be deducted as a business expense under Section 33(1) of the ITA. The IRB disallowed the deduction on the basis that the cash contribution was capital and penal in nature. During the hearing, the IRB focused on the point that the Bumiputera Unit Release Fee was a penalty, which was not wholly and exclusively incurred in the production of income.

The Special Commissioners of Income Tax (SCIT) agreed with the IRB and held that the taxpayer breached the State Government's circular by selling the shop lot units allocated for Bumiputera buyers to non-Bumiputera buyers. Having breached the said circular, the SCIT further held that the Bumiputera Unit Release Fee was penal in nature and

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hence, not incurred wholly and exclusively in the production of income.

The main issue for determination by the High Court was whether the Bumiputera Unit Release Fee incurred by the taxpayer is deductible under Section 33(1) of the ITA.

Submissions Before The High Court

The taxpayer's key arguments were as follows:

- For the purposes of deductibility, so long as a taxpayer fulfils the requirements stipulated in Section 33(1), the Bumiputera Unit Release Fee incurred by the taxpayer should be allowed as a deduction.
- The Bumiputera Unit Release Fee is an expense incurred in the course of the taxpayer's business as the shop lot units were the taxpayer's stock in trade and the taxpayer received income from the sale of the shop lot units.
- One must examine whether the Bumiputera Unit Release Fee was incurred "in the production of income" which means was the purpose of the expense was to enable the person to carry on and earn an income.
- The taxpayer is in the business of property development and derives income from the sale of its properties. By making the Bumiputera Unit Release Fee, the taxpayer is able to sell the unsold shop lot units which had been allocated to Bumiputera buyers and generate income.
- The nature of the Bumiputera Unit Release Fee is not penalty. The taxpayer did not infringe or breach any statutory law.
- Be that as it may, the taxpayer submitted that an expense that is penal in nature is still deductible. First, Section 39(1) of the ITA does not prohibit the deduction of Bumiputera Unit Release Fee. Secondly, there are various Commonwealth cases which have held that payments in nature of a violation of policy are

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deductible so long as it complies with the provision governing the deductibility of expenses.

Meanwhile, the IRB defended the ruling of the SCIT and argued that:

- The Bumiputera Unit Release Fee is penal in nature as the State Government had intended for the shop units to be sold to Bumiputera purchasers.
- An expense that is penal in nature is not incurred wholly and exclusively in the production of income.
- Furthermore, the taxpayer sold the shop lot units allocated to Bumiputera buyers to non-Bumiputera buyers before the taxpayer made the application to release the shop lot units allocated to Bumiputera buyers.
- One must look at the spirit of the circular issued by the State Government which intended to penalise property developers in order to curb the practice of releasing shop lot units allocated for Bumiputera buyers to non-Bumiputera buyers.

In response to the IRB's submission, the taxpayer's counsel argued that:

- The taxpayer submitted that it would be wrong in law to assume moral or ethical standards in allowing tax deduction.
- There was no unlawful business practice in the present matter and no violation of the law.
- The taxpayer had apportioned the amount of cash contribution and penalty paid to the State Government and sought deduction only of the capital contribution.

Decision

Upon hearing both parties and considering the facts of the case, the High Court ruled in favour of the taxpayer and allowed the taxpayer's appeal.

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This recent decision is encouraging as it recognises the position that Bumiputera Unit Release Fee incurred by property developers are indeed in the ordinary course of business and hence, are eligible for tax deduction. This case emphasises the position that the IRB should not arbitrarily disallow an expense as a deduction.

Authored by Nur Amira Ahmad Azhar¹

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How can we help you?

We are operating as usual and clients may pose any tax queries including those in relation to this alert via e-mail to:

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