10 AUGUST 2022

AMB v Ketua Pengarah Hasil Dalam Negeri

Contact Persons:

Datuk D P Naban
Senior Partner
Tax, SST & Customs Practice
+603 6209 5405
naban@rdslawpartners.com

S Saravana Kumar
Partner
Tax, SST & Customs Practice
+603 6209 5404
sara@rdslawpartners.com

Recently in *AMB v Ketua Pengarah Hasil Dalam Negeri*, the Special Commissioners of Income Tax (SCIT) allowed the taxpayer's appeal and held that the borrowing costs incurred by the taxpayer were tax deductible. The SCIT set aside the assessments raised by the Director General of Inland Revenue (DGIR).

The taxpayer was successfully represented by S. Saravana Kumar, the firm's Tax, SST & Customs partner.

This alert highlights the key points of this appeal.

Background

The taxpayer and its subsidiaries are in the business of the providing mobile, fixed line and international gateway telecommunications services as well as internet and broadband services. Consequent to a tax audit, the DGIR informed the taxpayer that the loan upfront fees were not deductible under Section 33(1) of the ITA. The DGIR also applied a modified formula of interest restriction calculation. The DGIR alleged that the taxpayer was negligent in preparing its tax returns.

The main issues considered by the SCIT were:

a) Whether the DGIR has successfully discharged its burden of proof as required under Section 91(3) of the ITA in relation to the issuance of the time-barred notices of additional assessment for the years of assessment (YAs) 2010 and 2011.

b) Whether the DGIR has any legal or factual basis to disallow the taxpayer to deduct the loan upfront fees as a deduction under Section 33(1) of the ITA for the YAs 2010 to 2014.

c) Whether the DGIR has any legal or factual basis to incorporate the additional factor of total dividend shortages into its method of apportioning the interest restricted under Section 33(2) of the ITA for the YAs 2013 and 2014.

The Taxpayer's Contentions

Time-barred Assessments

- The DGIR had no basis to invoke Section 91(3) to raise the time-barred assessments for the YAs 2010 and 2011. Under Section 91(1) of the ITA, the DGIR is only allowed to raise additional assessments within 5 years after the relevant year of assessment unless one of the exceptions in Section 91(3) exists.

- The DGIR had failed to discharge its burden of proof under Section 91(3). The taxpayer had filed its tax returns on time, sought advice from professional tax agents and stated its tax treatment for the deduction of loan upfront fees in its tax computations.

Deductibility Of Loan Upfront Fees

- The general rule is that expenditure incurred in the course of business is deductible if it falls under Section 33(1), known as the "basket provision".

- The crux of the dispute was whether the loan upfront fees incurred were revenue or capital in nature. The taxpayer's contention was that the loan upfront fees incurred were revenue in nature.

- The taxpayer submitted that the correct test to be applied in ascertaining the character of the financing expenses was to determine the purpose of the loan or financing which has been recognised by our courts and the Commonwealth courts as the proper test for determining the deductibility of financing costs.

- The DGIR had no basis to disallow the taxpayer's deduction of the loan upfront fees under Section 33(1) as the purpose of the RM1.2 billion loan was for on-lending to earn interest income and revenue in nature.

Formula Of Apportioning Interest Restriction

- Section 33(2) of the ITA provides for interest restriction but silent on the formula for calculation. However, a formula for interest restriction calculation is provided by the DGIR via its Public Ruling No.2/2011. The taxpayer applied this formula in computing the interest restriction.

- The formula does not require the additional factor of "dividend shortages" to be incorporated. It was therefore erroneous for the DGIR through the assessing officer to impose additional restriction and interpretation on the taxpayer especially when the wording of the formula is clear and simple. Public Ruling No. 2/2011 was made pursuant to Section 138A of the ITA which only allows for the DGIR to withdraw a public ruling and not to modify the public ruling as was done in this case.

The DGIR's Contentions

The DGIR submitted the following:

- The taxpayer had acted negligently and filed incorrect tax returns for the YAs 2010 to 2011, therefore falling within the ambit of the exception in Section 91(3)(b) of the ITA.

- The loan upfront fees incurred by the taxpayer for the YAs 2010 to 2014 are not deductible under Section 33(1) of the ITA.

- The "dividend shortages" must be incorporated in apportioning the interest restricted under Section 33(2) of the ITA.

The SCIT's Decision

The SCIT allowed the taxpayer's appeal and held that the DGIR had acted erroneously and without basis. The SCIT had decided that:

- The taxpayer had successfully proven that the assessments raised by the DGIR for the YAs 2010 and 2011 are time-barred under Section 91(1).

- Deduction under Section 33(1) is allowed for the upfront loan arrangement fee and legal fee incurred by the taxpayer for the YAs 2010 to 2014.

- The method of apportioning interest restriction used by the DGIR by including additional factor by incorporating the "dividend shortages" for the YAs 2013 and 2014 is not correct under Section 33(2) of the ITA.

Conclusion

This is a landmark ruling by the SCIT as loan upfront expenses such as loan arrangement fee and legal fee were held to be deductible expenditure. In the past, the SCIT have held that guarantee fees paid for a syndicated loan taken out to finance the taxpayer's property development business were deductible expenses under Section 33(1) of the ITA. The SCIT found that the nexus linking interest, guarantee fee and commitment fee were so integral to the loan package in that they represent different facets of the loans so crucial and critical to the realisation of the taxpayer's income.

This ruling follows the recent decision of the High Court in *Ketua Pengarah Hasil Dalam Negeri v Kulim (Malaysia) Bhd*, where it was held that borrowing costs such as legal and professional fee, arrangement fee and all other similar expenditure that are incidental and in relation to loans obtained by a taxpayer are deductible under Section 33(1) of the ITA.

The Indian Supreme Court in *The Bombay Steam Navigation Co v Commissioner of Income Tax* also held that in determining whether a particular expenditure is revenue expenditure incurred for the purpose of the business, all the facts and circumstances must be considered. The question must be viewed in the larger context of business necessity or expediency.

The common test is primarily the purpose test. The courts should look into whether the loans have created any asset or enduring benefit in determining the character of the loan itself. In the present appeal before the SCIT, the loans did not create any permanent asset or enduring benefit for the taxpayer in the sense that the loans did not result in the creation or possession of land, plants or machineries to the taxpayer. In

Contact Persons:

Datuk D P Naban
Senior Partner
Tax, SST & Customs Practice
+603 6209 5405
naban@rdslawpartners.com

S Saravana Kumar
Partner
Tax, SST & Customs Practice
+603 6209 5404
sara@rdslawpartners.com

The India Cements Ltd, it was held that a loan is not an asset or advantage of an enduring nature.

Authored by Dharshini Sharma, a Pupil with the firm's Tax, SST and Custom department.