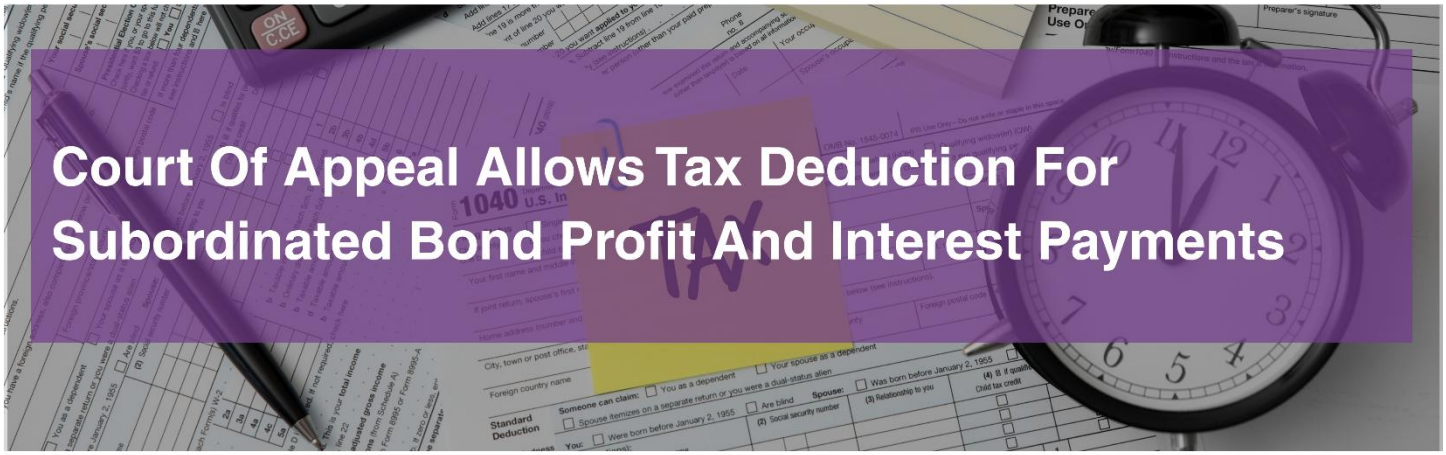
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Court Of Appeal Allows Tax Deduction For Subordinated Bond Profit And Interest Payments

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The Court of Appeal recently delivered its decisions in *EFTB v Ketua Pengarah Hasil Dalam Negeri* and *EGIB v Ketua Pengarah Hasil Dalam Negeri*, concerning the tax deductibility of payments incurred on Tier 2 Capital Subordinated Bonds. The EFTB Appeal concerned profit payments incurred by a takaful operator. Meanwhile, the EGIB Appeal concerned interest payments incurred by an insurance company.

The court allowed the appeal, holding that Sections 60 and 60AA of the Income Tax Act 1967 (ITA) did not preclude the application of the general deduction provision under Section 33(1) of the ITA to ordinary financing expenses incurred in the production of gross income.

The taxpayers were successfully represented by the firm's Tax, SST & Customs Partner, S. Saravana Kumar, together with Associate, Tan Jass Key.

Brief Facts

The taxpayers, EFTB and EGIB, were licensed takaful and insurance operators regulated by Bank Negara Malaysia (BNM).

In 2014, the taxpayers issued Tier 2 Capital Subordinated Bonds to raise additional capital to meet the minimum capital adequacy ratio requirements imposed by BNM. The additional capital enabled the taxpayers to maintain their regulatory capital adequacy ratios and continue underwriting new business.

EFTB paid profit to its subscribers in accordance with Syariah principles, while EGIB paid interest. Under Section 2(7) of the ITA, EFTB's profit payments were treated as interest for income tax purposes

The dispute concerned the deductibility of the payments for the years of assessment (YAs) 2014 to 2018, amounting to RM62,301,699. The taxpayers maintained that the payments had been incurred wholly and exclusively in the production of gross income and were therefore deductible under Section 33(1).

Both the Special Commissioners of Income Tax (SCIT) and the High Court disallowed the deductions, holding that Sections 60 and 60AA were specific provisions governing the computation of income of insurance and takaful operators and prevailed over Section 33(1).

Aggrieved by the decisions of the SCIT and High Court, the taxpayers subsequently appealed to the Court of Appeal.

The Issue Before The Court of Appeal

The principal issue was whether the profit and interest payments incurred on the Tier 2 Capital Subordinated Bonds were deductible under Section 33(1).

The Taxpayers' Contentions

The taxpayers submitted that the payments were deductible under Section 33(1) for the following reasons:

(a) The taxpayers distinguished the earlier majority decision in *Etiqa Family Takaful Bhd (previously known as Etiqa Takaful Bhd) v Ketua Pengarah Hasil Dalam Negeri* [2025] 2 MLJ 536. That case concerned commission expenses arising from the distinctive nature of takaful business, which were specifically addressed by Section 60AA(9)(b)(iv). By contrast, the present appeals concerned ordinary financing expenses that were not specific to takaful operations;

(b) Instead, the minority decision in *Etiqa Family Takaful Berhad* should be followed;

(c) Sections 60AA and 60 merely prescribed the methods of computing adjusted income of insurance and takaful operators, respectively, but did not constitute exhaustive codes governing all available deductions. Where Parliament intended to exclude Section 33(1), it did so expressly, as demonstrated by Sections 60H(6) and 65E(12). No such express exclusion appeared in Section 60AA or Section 60;

(d) The taxpayers relied on *The Great Eastern Life Assurance Co Ltd v Director General of Inland Revenue* [1987] 2 MLJ 529, where the Privy Council recognised that Section 60 was concerned with the computation of adjusted income and was not to be treated as an exclusive code displacing the general provisions of the ITA. The Inland Revenue Board (IRB) could not approbate and reprobate by adopting an interpretation of Sections 60 and 60AA as non-exhaustive for the purposes of chargeability, but as an exclusive code for the purposes of deductibility;

(e) Section 52 of the ITA expressly preserved the application of the general provisions of the ITA, subject to any inconsistency. There was no inconsistency between Section 33(1) and Sections 60AA or 60 in respect of the payments in question;

(f) Section 33(1) was the general "basket" provision governing deductions. The ITA operated by way of a negative list. Unless Parliament expressly prohibited a deduction, a taxpayer remained entitled to rely on Section 33(1); and

(g) The requirements of Section 33(1) had been satisfied. The evidence adduced at trial established the nexus between the subordinated bonds, the payments made to the subscribers and the production of the taxpayers' gross income. The evidence was not challenged by the IRB in cross-examination.

The IRB's Arguments

The IRB, on the other hand, contended that the profit and interest payments were not deductible for the following reasons:

(a) Section 60AA and Section 60 constituted specific statutory regimes governing the computation of adjusted income of takaful and insurance operators, respectively. Accordingly, the deductions available to the Shareholders' Fund were limited to those expressly prescribed under Sections 60AA(9)(b) and 60(3A)(b);

(b) Sections 60AA(9)(b) and 60(3A)(b) provided an exhaustive list of deductions available to the Shareholders' Fund. As the profit payments and interest payments were not expressly listed, they were not deductible;

(c) The specific provisions in Section 60AA and Section 60 prevailed over the general deduction provision in Section 33(1), applying the principle of *generalia specialibus non derogant*;

(d) Section 52 of the ITA required the general provisions of the ITA to be modified to the extent necessary to give effect to the specific provisions governing the computation of income of takaful and insurance operators; and

(e) The earlier majority decision of the Court of Appeal in *Etiqa Family Takaful Bhd* was binding and supported the IRB's position that Section 60AA and Section 60 constituted an exclusive code governing the deductibility of expenses incurred by takaful or insurance operators.

The Court of Appeal's Decision

The Court of Appeal allowed the appeals and set aside the decisions of the SCIT and the High Court. For the purposes of this alert, the statutory provisions and issues discussed below are addressed by reference to EFTB, in accordance with the Court of Appeal's grounds of judgment. The Court of Appeal's key findings were as follows:

(a) Section 60AA(9)(b) was a computation provision

(i) Section 60AA was enacted to address the distinctive three-fund structure of takaful operators, namely, the General Takaful Fund, Family Takaful Fund and Shareholders' Fund. It facilitated the attribution of income and expenditure between the funds and gave effect to Shariah-specific flows;

(ii) The items listed in Section 60AA(9)(b) were fund-specific or Shariah-specific expenses whose attribution could not be achieved adequately by the ordinary machinery of the ITA. Within that specific field, the list was exhaustive;

(iii) However, this did not mean that every expense incurred by a takaful operator was governed exclusively by Section 60AA(9)(b). The provision did not exclude Section 33(1).

(b) Section 60AA did not silently oust Section 33(1)

(i) A purposive approach to statutory interpretation could identify the field and purpose of a provision but could not imply an exclusion of Section 33(1) that Parliament had not enacted. Reading Section 60AA as excluding the general deduction provision would impose a restriction on a taxpayer's deduction by implication;

(ii) Section 52 of the ITA expressly preserved the application of the general provisions, subject only to the extent of any inconsistency. As Section 33(1) and Section 60AA(9)(b) operated in different fields, they could be applied concurrently. Accordingly, the principle of *generalia specialibus non derogant* did not apply;

(iii) The court relied on *Great Eastern*, which recognised that the specific provisions governing the computation of income of insurance companies were not an exhaustive code displacing the general deduction provisions;

(iv) Where Parliament intended to exclude Sections 33 and 34, it did so in express terms (for example, Sections 60H(6) and 65E(12)). No equivalent exclusion appeared in Section 60AA;

(c) The earlier majority decision in *Etiqa Family Takaful Bhd* was distinguishable:

(i) The Court distinguished the earlier majority decision in *Etiqa Family Takaful Bhd*, which concerned commission expenses incurred by the Shareholders' Fund to earn wakalah fees. Those expenses were specific to takaful operations and fell within Section 60AA(9)(b);

(ii) The earlier decision did not determine whether ordinary financing costs, which may also be incurred by companies that are not takaful operators, were deductible under Section 33(1). It was therefore not an authority on the issue before the court;

(d) The profit payments were ordinary financing expenses

(i) The raising and servicing of regulatory capital was not a distinctive feature of takaful business. EFTB incurred the costs in their capacity as financial institutions would incur the same type of expenses;

(ii) The profit payments were therefore financing costs governed by Section 33(1), rather than expenses falling within the closed list under Section 60AA(9)(b). By virtue of Section 2(7) of the ITA, the profit payments were treated as interest for income tax purposes; and

(iii) The requirements of Section 33(1) were satisfied. The evidence established that, without the additional capital, EFTB would have been unable to meet capital adequacy ratio and underwrite new business, directly affecting its income. This evidence was not challenged in cross-examination, and the necessary nexus between the borrowing, the payments and the production of gross income was established.

Significance Of The Decision

The decision provides a welcome and significant clarification of the scope and application of Sections 60AA and 60 of the ITA, as well as their interaction with the general deduction provision under Section 33(1).

In particular, the decision distinguishes the earlier majority decision in *Etiqa Family Takaful Berhad v Ketua Pengarah Hasil Dalam Negeri* [2025] 2 MLJ 536, which concerned commission expenses arising from the distinctive nature of takaful business and specifically addressed by Section 60AA(9)(b)(iv). The Court clarified that Section 60AA(9)(b) does not constitute an exhaustive code governing all expenses incurred by a takaful operator. Rather, its scope is confined to expenses falling within the specific field addressed by that provision.

Accordingly, ordinary financing expenses incurred wholly and exclusively in the production of gross income, which do not arise from the distinctive three-fund structure of takaful operations, remain deductible under Section 33(1). In the absence of an express statutory exclusion or inconsistency with the specific provisions, Section 33(1) continues to apply. The decision also reinforces the applicability of this principle in the context of insurance companies.

The decision is of particular interest to takaful operators, insurance companies and other regulated financial institutions when assessing the deductibility of ordinary business and financing expenses under the ITA.

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