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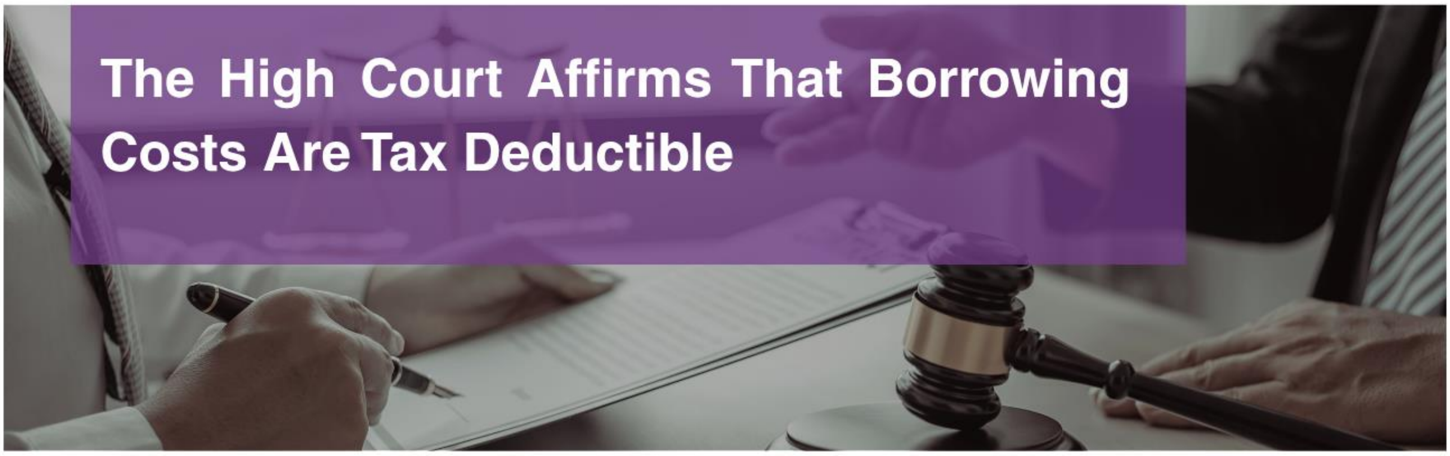
The High Court Affirms That Borrowing Costs Are Tax Deductible



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Recently, the High Court upheld the decision of the Special Commissioners of Income Tax (SCIT) in *MB v Ketua Pengarah Hasil Dalam Negeri* (2022) MSTC 10-154, that the borrowing costs incurred by the taxpayer were deductible under Section 33(1) of the Income Tax Act 1967 (ITA). The court also ruled that the Director General of Inland Revenue (DGIR) could not deviate from the interest restriction formula set out in its own public rulings.

The taxpayer was successfully represented by the firm's Tax, SST & Customs Partner, S. Saravana Kumar, together with associate, Lim Chinn Wei.

Background

The taxpayer was an investment holding company engaged in the business of providing mobile communication services. As part of its business operations, the taxpayer procured a loan of RM2.55 billion, of which RM1.2 billion was on-lent to one of its subsidiaries. In relation to the RM1.2 billion loan, the taxpayer incurred loan upfront fees, which consisted of loan arrangement fees and legal fees. The taxpayer derived interest income from the on-lending arrangement.

Following a tax audit, the DGIR informed the taxpayer that the loan upfront fees were not deductible under Section 33(1) and that the taxpayer had been negligent in preparing its tax returns. On a separate issue in relation to another transaction, the DGIR also applied a modified formula for calculating interest restriction, deviating from the method stated in the DGIR's public ruling.

Consequently, the DGIR raised additional assessments for the Years of Assessment (YAs) 2010 to 2014 against the taxpayer. Aggrieved by the said assessments, the taxpayer appealed to the SCIT.

The SCIT allowed the taxpayer's appeal on the following grounds:

(i) The taxpayer was not negligent and the issues at hand concerned technical interpretation;

(ii) The loan upfront fees were wholly and exclusively incurred in the production of the taxpayer's income; and

(iii) The DGIR was not allowed to modify the formula for calculating interest restriction provided in its public ruling.

The DGIR then appealed to the High Court.

Issue 1 – Time-Barred Assessments

The DGIR alleged that 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 taxpayer highlighted the recent Court of Appeal ruling in *Ketua Pengarah Hasil Dalam Negeri v Etiqa Family Takaful Berhad* [2024] CLJU 2690, which held that a reasonably different interpretation of the law cannot be held as negligence within the meaning of Section 91(3). The Court of Appeal further held that differing views and taking a more favourable view to a taxpayer is acceptable and reasonable care is regarded as being taken when there is consultation with a competent advisor. Similarly, the Court of Appeal in *Keysight Technologies Malaysia Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri* [2025] 1 CLJ 883 also held that a taxpayer cannot be said to be negligent for making a return on a tax position by relying on professional advice.

The High Court found that a reasonably different interpretation can hardly be held as negligence. The SCIT had correctly decided that there were no elements of negligence, making the assessments raised for the YAs 2010 and 2011 time barred.

Issue 2 – Deductibility Of Loan Upfront Fees

The DGIR argued that the "loan upfront fees" and "interest expenses" were not analogous, particularly as the loan upfront fees were incurred prior to the disbursement of the loan. On this basis, the DGIR argued that the loan upfront fees were capital in nature and thus, not deductible.

In response, the taxpayer highlighted that the Court of Appeal in various cases have recognised that financing expenses were allowable for tax deduction (*PO(M)SB v Ketua Pengarah Hasil Dalam Negeri*).

The taxpayer further argued that the purpose of the RM1.2 billion loan was for further on-lending to earn interest income and therefore, was revenue in nature. Since there was a direct linkage or nexus between the loan upfront fees and the purpose of the RM1.2 billion loan, the loan upfront fees would derive its character from the RM1.2 billion loan to be revenue in nature.

The High Court agreed that the loan upfront fees were incurred by the taxpayer to generate its business income and were not to raise its capital. Therefore, the loan upfront fees incurred were wholly and exclusively in the production of the taxpayer's income and hence, deductible under Section 33(1).

Issue 3 –Apportionment Interest Restriction

The DGIR took the view that the "total dividend shortage" must be incorporated in apportioning the interest restricted under Section 33(2) of the ITA on the basis that certain portion of the loan obtained was used to pay dividend and therefore, all costs in relation to that portion were not deductible. The DGIR also argued that this was not a personal requirement but an amount which it considered just and reasonable in all the circumstances.

Section 33(2) provides for interest restriction but was silent on the formula for calculation. In this regard, the taxpayer had relied on the formula for interest restriction calculation that was provided by the DGIR via its Public Ruling No.2/2011.

The taxpayer argued that the formula does not require the additional factor of dividend shortage to be incorporated. The taxpayer further argued that Public Ruling No. 2/2011 was made pursuant to Section 138A of the ITA, which only allows the DGIR to withdraw a public ruling and not to modify it as was done in this matter. More importantly, the taxpayer highlighted that Section 138A(3) of the ITA provides that where a person has applied a particular provision in the manner stated in a public ruling made by the DGIR, the DGIR shall apply the provision in relation to the person and the arrangement in accordance with the ruling. It was therefore erroneous for the DGIR to impose an additional restriction on the taxpayer.

The High Court agreed with the taxpayer and held that the taxpayer was not empowered to modify the formula for interest restriction.

Conclusion

Based on the above, the High Court found that Section 113(2) of the ITA has not been satisfied for the DGIR to impose penalty against the taxpayer and accordingly, the DGIR's appeal was dismissed.

This is a welcomed decision as it aligns with well-established principles that financing expenses are deductible under Section 33(1) and that a taxpayer cannot be held negligent for simply adopting a differing view from the DGIR.

The High Court's decision also confirms that the DGIR is not allowed to incorporate additional conditions against taxpayers as was done in this matter. Although the DGIR's public ruling generally has no legal effect and is not binding on a taxpayer, the DGIR nevertheless must give effect to a particular provision in the public ruling if the taxpayer has applied that provision in accordance with the public ruling.

Finally, the mere fact that the taxpayer takes a different approach in its tax treatment, it does not mean that taxpayer was negligent.

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