

DALAM MAHKAMAH TINGGI MALAYA DI KUALA LUMPUR

(BAHAGIAN RAYUAN & KUASA-KUASA KHAS)

**RAYUAN SIVIL NO: R1-14-17-2009**

ANTARA

FEDERAL FURNITURE HOLDINGS SDN BHD ... PERAYU

DAN

KETUA PENGARAH HASIL DALAM NEGERI ... RESPONDEN

**ALASAN PENGHAKIMAN**

The Appellant appeals to the SCIT against the assessment made by the Respondent under the Income Tax Act 1967 (“the Act”) as follows –

Year of Assessment	Type Of Assessment	Date of Assessment	Amount (RM)
2002	Original	28.08.2006	31,270,40
2003	Original	28.08.2006	54,761.08

2. The issue submitted to the SCIT for determination is whether the interest expenses for the Year of Assessment 2002 and the Year of Assessment 2003 arising from the giving of interest free loans by the Appellant to its subsidiaries are wholly and exclusively incurred in the production of gross income within

the meaning of Section 33 of the Income Tax Act 1967 (“the Act”) which provides as follows –

... the adjusted income of a person from a source for the basis period for year of assessment shall be an amount ascertained by deducting from the gross income of that person from that source for that period all outgoings and expenses wholly and exclusively incurred during that period by that person in the production of gross income from that source ...

3. The SCIT dismissed the Appellant’s appeal. By a Deciding Order dated 30.10.2008 the SCIT decided as follows –

ADALAH DIPUTUSKAN bahawa bayaran faedah bagi Tahun Taksiran 2002 dan Tahun 2003 yang timbul dari pemberian pinjaman tanpa faedah kepada anak-anak syarikat adalah tidak dibenarkan sebagai perbelanjaan dalam menghasilkan pendapatan kasar di bawah maksud Seksyen 33 Akta Cukai Pendapatan 1967

Dissatisfied with the decision of the SCIT, the Appellant now appeals against the Deciding Order. Having heard submissions I dismissed the appeal with costs of RM3,000.00 to the Respondent.

4. Before the SCIT the following facts were admitted or proved (paragraph 6 of Case Stated) –

(i) the Appellant is an investment holding company;

- (ii) the Appellant has nine direct subsidiaries and eight indirect subsidiaries in the years of assessment 2002 and 2003;
- (iii) the Appellant borrowed money from financial institutions in 2002 and 2003 for revolving credit facilities, hire purchase and finance leases and short term loans;
- (iv) the short term loans were taken to finance the business activities of the Appellant and its subsidiaries;
- (v) in the years of assessment 2002 and 2003, the Appellant lent or advanced money to its subsidiaries;
- (vi) money lent or advanced to some of its subsidiaries were interest free;
- (vii) there are no details on which of the Appellant's subsidiaries received interest free loan and which received interest bearing loan;
- (viii) some of the subsidiaries are dormant and some have even ceased operations and there are no details whether these companies received interest free or interest bearing loan;
- (ix) the field audit on the Appellant was carried out by the Respondent at the Appellant's business premises on 19.4.2006 until 20.4.2006;
- (x) before the audit, by a letter dated 2.3.2005 the Respondent requested that the Appellant submit its audited accounts, tax computation and other relevant documents and by a letter dated 4.3.2005 the Appellant submitted the documents requested, together with annual reports for the Years of Assessment 2001-2003, but not the audited accounts;
- (xi) the audit findings, as per letter dated 5.5.2006 was only on certain disallowable expenses. The issues on interest

restriction was never a part of the findings and was only later raised by the Appellant in its letter dated 17.5.2006;

- (xii) by way of letter dated 23.5.2006, the Appellant requested for a revision of the interest restriction computation and enclosing revised tax computation and revised return forms for the Years of Assessment 2001-2003;
- (xiii) the revised tax computation and the revised return forms as submitted by the Appellant do not alter the disallowable expenses as per the Respondent's audit findings and as agreed upon by the Appellant;
- (xiv) the amount of interest expenses in the original income tax computation and in the revised income tax computation for the relevant years of assessment are as follows –

<b>Income Tax Computation</b>	<b>YA 2002</b>	<b>Page of Exhibit E1</b>	<b>YA 2003</b>	<b>Page of Exhibit E1</b>
Original	1,187,248.00	137	1,329,198.00	154
Revised	2,336,804.00	16	2,569,830,00	17

- (xv) in the Original Computation of Interest Restriction as submitted by the Appellant for the Years of Assessment 2001-2003, under the item 'Investments', the amount **due** from subsidiaries was classified **into** 'interest free' and 'interest bearing';
- (xvi) in the revised Computation of Interest Restriction as submitted by the Appellant for Years of Assessment 2001-2003, under the item 'Investments', the amount due from subsidiaries was no longer classified into 'interest free' and 'interest bearing' categories;

- (xvii) by letter to the Appellant dated 14.8.2006, the Respondent gave reasons for the disallowance of the interest expenses, specifically at paragraph 3 of the letter which reads –

“Dukacita dimaklumkan bahawa rayuan tuan terhadap pengiraan faedah tidak dapat dipertimbangkan kerana pinjaman yang telah dikeluarkan kepada subsidiary adalah tanpa mengenakan faedah. Fakta ini adalah tidak menyamai prinsip di dalam kes Multi Purpose yang mengaitkan pinjaman yang diberikan adalah dikenakan faedah. Ini bermakna pinjaman yang diberikan bukan merupakan punca pendapatan dari mana pendapatan boleh dihasilkan.”

- (xviii) in disallowing the interest expenses claimed by the Appellant, the Respondent did not go on a counter to counter basis but on the classification by the Appellant of the amount due from subsidiaries as ‘interest free’ and ‘interest bearing’;
- (xix) the source of information that some of the loans given by the Appellant to its subsidiaries were interest bearing and some were interest free were the Financial Statements in the Appellant’s Annual Report 2002 and Annual Report 2003 as submitted to the Respondent by letter dated 4.3.2005 prior to the audit exercise;
- (xx) based on the audit findings and the Respondent’s approach with regard to the interest restriction issue, the assessments were issued under subsection 91(1) of the Act being best judgment assessments of the Respondent;
- (xxi) being aggrieved with the assessments for Y/A 2002 and 2003 dated 28.8.2006, the Appellant submitted Form Q each dated 25.9.2006.

*Appellant's contention :*

- 5.(a) that both interest bearing loans and non interest bearing loans constitute a single source of income;
- (b) that the same principle as applied to dividend is equally applicable to interest income. Section 4(c) of the Act provides for “dividends; interest or discounts” to be grouped under one category. In as much as dividends from all counters of shares, whether income producing or otherwise, are classified as a single source of income, so should all interest incomes be treated as a single source of income whether the loans are income producing or non income producing.

*Respondent's contention :*

- 6.(a) that the interest free loans given to the Appellant's subsidiaries do not generate income, whether present or future, to the Appellant. They are not a source of income and will never be a source of income so long as they are interest free;
- (b) in disallowing the interest expenses claimed, the Respondent did not go on a counter to counter basis but on the classification by the Appellant of the amount due from subsidiaries as “interest free” and “interest bearing”.

7. Before the SCIT the Appellant contended that the principle of law established by the case of *MP Holdings Sdn Bhd v KPHDN* (2000) MSTC 3115 and *Ketua Pengarah Hasil Dalam Negeri v Multi-Purpose Holdings Bhd* [2002] 1 MLJ 22 apply. In that case the tax payer received interest income from the giving of interest bearing loans to related companies. Revenue had treated each loan given by the tax payer as separate sources of income. The taxpayer argued that under Section 33 dividend income and interest income should be treated as distinct and singular sources of income however or from wherever derived. It was contended amongst others that Revenue had ignored the scheme of the Act and had arbitrarily fragmented into further sub-divisions and in a manner unauthorized by law. The SCIT agreed with the taxpayer and ruled that Revenue could not further sub-divide each source by treating each loan as a separate source, and to treat each loan as a separate source is to disintegrate the groupings or categories further than what is authorized by the Act. On appeal Revenue argued that under Section 33 the word “source” referred to the activity which produces income, the originating cause of the income. Therefore the word “source” referred to each loan. Words used under Section 4 including “interest” was not a “source” by itself. The High Court dismissed the appeal and held *inter alia* that six classes of income chargeable to tax were provided in Section 4 of the Act and ‘each source’ in Section 5 mean the sources of income set out in Section 4 which include an ‘interest’ source of income in Section 4(c). The High Court agreed with the taxpayer that if Parliament intended that each loan should be regarded as

separate sources, Section 4(c) would be differently worded to reflect that. The High Court held that the Act identified the subject matter of taxation as 'dividends' and 'interest' and Revenue did not have the authority to split this classification up in a manner that increased the taxpayer's liability to tax.

8. Based on the above case the Appellant contends that –
  - (a) incomes which are chargeable to tax are categorized under six groups by Section 4 of the Act. In the case of share investment, it is not permissible to treat each counter of share investment as a separate source or apportion the dividend between income producing and non income producing, and it was not open to the Respondent to further subdivide each source or to say that each lending to each subsidiary constitutes a separate activity and a separate source and if there is no or insufficient income the cost (interest) cannot be utilized to set off against income from lendings to other subsidiaries,
  - (b) that the same principle as applied to dividend is equally applicable to interest income, since Section 4(c) of the Act grouped "dividends, interest and discounts" under one category.

8. The Appellant also referred to the case of *Vallambrosa Rubber Co. Ltd v Farmer* 5 TC 529 where the court decided that the expenses incurred for the entire estate is allowable expenditure although only one-seventh had reached the latex producing age. This is to support the testimony of AW1 that the interest free loans were not intended to be interest free and that only when a subsidiary is in profitable position would interest be charged. However the SCIT found that the Appellant failed to produce any evidence to support this contention.

9. The Respondent took the stand that as opposed to interest bearing loans, the interest free loans given to the Appellant's subsidiaries do not generate income, whether present or future. They are not a source of income and will never be so long as they are interest free. Once that is established, the Respondent submits that related interest expenses are not allowable as deductions because the expenditure is not in the production of income at all. Further in disallowing the interest, the Respondent accepted the classification made by the Appellant itself of the amount due from subsidiaries as 'interest free' and 'interest bearing loans'.

10. The SCIT found that both the SCIT and the High Court in the case referred to made their decisions with reference to subdivision of sources of income, not on subdivision between

what is a source of income and what is not a source of income. In the Multi Purpose case, the taxpayer received interest income from the giving of interest bearing loans to related companies, and as such all the loans were a source of income, present or future. The SCIT is of the opinion that the groupings in Section 4 of the Act was not dealt with specifically in the cases cited. The SCIT believes that the grouping in Section 4 is entirely for convenience and simplification. There are other related provisions in determining the income. For 'dividend', there is section 14 of the Act which provides the basis and the legal requirement for it to be assessed, while for 'interest' the relevant section is section 15 of the Act. These two sections stood entirely and independently. The SCIT is of the view that this argument cannot stand considering that under Section 4(d) "rent, royalties or premium" are also grouped together.

11. The SCIT found that the material issue is whether the subsidiary or subsidiaries had obtained 'interest free' or 'non interest free' loan arrangement with the Appellant. The relationship between the Appellant and each of its subsidiary is independent and separate. The SCIT found that in this appeal though the Respondent had made a sub-division, it was between a source of income (the interest bearing loans) and a non source of income (the interest free loans). The SCIT agreed with the Respondent that on the 'interest free' loans, there was no source of income derived by the Appellant from its subsidiaries. The

SCIT found the method adopted by the Respondent to be correct in law. Therefore the SCIT concluded that the decision of the Respondent in disallowing the interest expenses relating to the interest free loan is not against the principles established in the Multi Purpose case. Consequently the SCIT unanimously dismissed the appeal and confirmed the relevant assessments made.

### *Decision*

12. In this appeal the relevant provisions of the Act are Sections 2, 3, 4 and 33. Section 2 of the Act defines the word 'source' as 'a source of income'. Section 3 of the Act provides as follows –

#### **Charge of income tax**

3. Subject to and in accordance with this Act, a tax to be known as income tax shall be charged for each year of assessment upon the income of any person accruing in or derived from Malaysia or received in Malaysia from outside Malaysia.

Liability to pay income tax is dependent on whether such income is chargeable to tax. The classes of income chargeable to tax are specified under Section 4 are as follows -

#### **Classes of income on which tax is chargeable**

4. Subject to this Act, the income upon which tax is chargeable under this Act is income in respect of –

- (a) gains or profits from a business, for whatever period of time carried on;
- (b) gains or profits from an employment;
- (c) dividends, interest or discounts;
- (d) rents, royalties or premiums;
- (e) pensions, annuities or other periodical payments not falling under any of the foregoing paragraphs;
- (f) gains or profits not falling under any of the foregoing paragraphs.

Hence Section 4 provides that 'interest' is a class of income upon which tax is chargeable under Section 3. But whether tax is chargeable upon such 'interest', reference must be made to section 33.

13. Section 33 of the Act provides *inter alia* that all outgoings and expenses wholly and exclusively incurred in the production of gross income from a source may be deducted from the gross income from that source, and in respect of any sum payable by way of interest upon any money borrowed, if the money borrowed is employed in the production of gross income from that source (Section 33(1)(a) of the Act).

14. The admitted facts are that the Appellant took short term loans from financial institutions to finance the business activities of the Appellant and its subsidiaries. For these loans the

Appellant incurred interest expenses. The loans taken by the Appellant were employed for the purpose of giving interest bearing and interest free loans to its subsidiaries. In the years of assessment 2002 and 2003, the Appellant lent or advanced money to its subsidiaries some of which as admitted, are dormant and some have even ceased operations.

15. The Appellant classified the loans given to its subsidiaries into two types i.e. interest bearing loans and non interest bearing loans. But no details were provided as to which subsidiary received what type of loan. The non interest bearing loans are thus not employed in the production of the Appellant's gross income. I agree with the Respondent and the SCIT that to allow the interest expenses incurred in respect of the loans taken by the Appellant from which interest free loans were given by the Appellant to its subsidiaries would be contrary to the Act. The interest expenses incurred upon loans which were utilized to give interest free loans to its subsidiaries were not interest expenses incurred in the production of the Appellant's gross income. Hence I am of the opinion that for the purpose of Section 33 it is therefore necessary for the Respondent to distinguish between the interest bearing loans from the non interest bearing loans.

16. With regard to the submissions by counsel for the Appellant that since Section 4(c) of the Act grouped "dividends, interest and discounts" under one category therefore the principle

as applied to dividend is equally applicable to interest income, I agree with the SCIT that on the basis that there are separate provisions pertaining to dividend income (Section 14) and to interest and royalty income (Section 15), principles that apply to dividend income would not necessarily apply to interest and royalty income merely because dividend, interest and royalty income are grouped under one class.

17. With regard to the case of Multi Purpose cited by the Respondent, the facts in that case show that all the loans made to the related companies by the taxpayer were interest bearing loans. Therefore the High Court in that case found that to further subdivide the source of income is to disintegrate the groupings or categories further than what is authorized by the Act. The loans in Multi Purpose are unlike the loans in the present appeal. I am of the view that on the facts the case of Multi Purpose is distinguishable from the present case. As I have mentioned in paragraph 15 above, in this case the subdivision of the interest bearing loans from the non interest bearing loans was necessary for the purpose of Section 33. For the aforementioned reasons I dismissed the appeal with costs as ordered.

Dated 23.4.2010

**DATO' AZIAH ALI  
HAKIM  
MAHKAMAH TINGGI MALAYA  
KUALA LUMPUR**

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