

WHAT CONSTITUTES INCOME IN THE CONTEXT
OF SECTION 4 INCOME TAX ACT 1967 AND
JUDICIAL INTERPRETATIONS



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WHAT CONSTITUTES INCOME IN THE CONTEXT
OF SECTION 4 INCOME TAX ACT 1967 AND
JUDICIAL INTERPRETATIONS

BY

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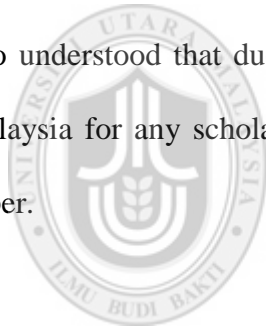


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Abstract

The study in this project paper is quiet specific whereby the whole discussion revolves around section 4 Income Tax Act 1967 which defines income. Perusing the cases involving income tax, it is obvious that most of the cases revolve around issue of what constitutes income. This is due to the inadequacies of section 4 Income Tax Act 1967 in effectively defining income.

The objectives of this project paper is to discuss the current position involving this section and the definitions judicially elaborated by courts to help fill in the *lacuna* created by the inadequacies this section. It also involves comparative study with other jurisdiction namely with India and United Kingdom and recommendations to solve the problem namely amendments to the section in the form of adding provisos and illustrations.

As the study in this project paper is about what constitutes income in context of Income Tax Act 1967, major portion of the paper involves discussion on the issues which frequently goes to court for the much needed guide as to what forms income. This will greatly help individuals or organizations namely taxpayers looking for a clue of what section 4 Income Tax Act 1967 trying to classify. It will also give the readers an overview of what is income in revenue law.

Abstrak

Perbincangan dalam kertas projek ini adalah amat khusus di mana keseluruhan perbincangan berkisar mengenai seksyen 4 Akta Cukai Pendapatan 1967 yang mendefinisikan maksud pendapatan. Rujukan kepada kes-kes yang melibatkan cukai pendapatan adalah menjelaskan bahawa kebanyakannya melibatkan isu apakah yang ditakrifkan sebagai pendapatan. Ini adalah kerana seksyen 4 Akta Cukai Pendapatan 1967 gagal menafsirkan maksud pendapatan secara efektif.

Objektif kertas projek ini adalah untuk membincangkan kedudukan semasa melibatkan seksyen ini dan definisi kehakiman yang dihuraikan oleh mahkamah untuk membantu mengisi *lacuna* yang diwujudkan oleh kelemahan seksyen ini. Ianya juga melibatkan kajian perbandingan dengan bidang kuasa negara lain iaitu dengan India dan United Kingdom dan cadangan untuk menyelesaikan masalah ini dalam bentuk pindaan kepada seksyen ini dengan menambah proviso dan ilustrasi.

Oleh kerana perbincangan kertas projek ini adalah berhubung dengan takrifan pendapatan dalam konteks Akta Cukai Pendapatan 1967, maka sebahagian besar perbincangan adalah melibatkan isu yang kerap dirujuk ke mahkamah untuk mendapat panduan berhubung apakah yang membentuk pendapatan. Ini akan membantu individu dan organisasi terutamanya pembayar cukai yang ingin mencari pengertian yang cuba diklasifikasikan oleh seksyen 4 Akta Cukai Pendapatan 1967. Ia juga akan memberikan pembaca satu pandangan menyeluruh akan maksud pendapatan dalam undang-undang cukai pendapatan.

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I take this opportunity to extend my thanks and gratitude to all the lecturers who has taught and guided me throughout my journey in completing my study for Masters in Corporate Law.

I dedicate this work to the memory of my beloved father, late Mr. Narasamuloo Appanan and to my mother Mrs. Dunalekchery Sannasy. Without her support, love, encouragement, sacrifice and prayers this may not been possible.

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CHAPTER ONE

BACKGROUND

1.1 Introduction

Income tax as everyone knows, at its onset forms an important part of everybody's life, be it an individual, a company, an organisation, non-governmental organisation or country. Income Tax form part of revenue for government whilst tax payers see it as unavoidable expenses, pecuniary liability. Thus, as a matter of prudence it is very important to have a good working knowledge of what actually forms income that could be taxed and the exemption thereto.

Generally, Income Tax is the payment levied on the income of individuals and businesses including corporations or other legal entities. Various income tax systems exist, with varying degrees of tax incidence. It could be progressive, proportional or regressive. When tax is levied on the income of companies, it is often called a corporate tax or profit tax. Individual income taxes often tax the total income of the individual subject to certain exemptions. Various systems define income differently, and often allow notional reductions of income.

In Malaysia income tax is generally governed by Income Tax Act 1967 (Act 53/1967). Any particular dealing or transactions must come within the walls of scope of charge particularly as stipulated in section 3 of the act for it to be accounted to chargeable income tax. Any transactions or dealings that fall outside the scope of

section 3 Income Tax Act 1967, shall not be accounted for the purposes of income tax or free of tax in a more common way.

Before going into this deduction there is another major issue that needs to be ascertained, that is income itself. There are two crucial issues to be determined here, that is tax itself and the primary issue being what constitutes income. For this the provisions regulating tax must be comprehensive so as to avoid any inconvenience such as uncertainties which will directly cause disputes to be resolved by way of trials and this will obviously involve incurring cost and time.

1.2 Problem statement

Income tax forms integral part of revenue. In so far as tax payers are concerned every cent taxed will affect them financially. The crucial issue to be determined in tax obviously is income and as such what is actually income becomes mandatory issue to be determined. In so far as Malaysia is concerned Section 4 Income Tax Act 1967 which defines income merely gives brief categories of income without defining it in detail and this has created *lacuna* which is evident from the brief wording of the statute and the many cases decided in courts pertaining to this issue.

Section 4 & Section 4A Income Tax Act 1967 provides for this limb but the statute did not clearly define what constitutes income. Both the section did not define income but generally categorises it. It is the courts that has been playing vital role in shading the much needed light to define what in actual sense forms income. The

precedence clearly non exhaustive as the interpretation of what forms income is purely subjective and depends heavily on the circumstance and facts of each case.

At this juncture it is important to note the wordings of section 3 Income Tax Act which reads as:-

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

Section 3 stipulates two main situations when liability to pay tax arises:-

- i) The dealing is an income and is derived from Malaysia; or
- ii) The dealing is an income and the said income is received in Malaysia from outside Malaysia.

Section 4 Income Tax Act 1967 on the other hand stipulates classes of income on which tax is chargeable. The section states:-

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 profit 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*

Section 4A Income Tax 1967 states:-

“Notwithstanding the provisions of section 4 and subject to this Act, the income of a person not resident in Malaysia for the basis year for a year of assessment in respect of :-

- i) Amounts paid in consideration of services rendered by the person or his employee in connection with the use of property or rights belonging to , or the installation or operation of any plant, machinery or other apparatus purchased from, such persons;*
- ii) Amounts paid in consideration of technical advice , assistance or services rendered in connection with technical management or administration of any scientific , industrial or commercial undertaking, venture, project or scheme; or*
- iii) Rent or other payments, not being payments of film ’s rentals, made under any agreement or arrangement for the use of any moveable property which is derived from Malaysia is chargeable to tax under this act.*

Even though income had been categorized into paragraph (a) to (f) of section 4 they are not exhaustive. In the case of *ALB Co. Sdn. Bhd. v Director General of Inland Revenue* (1979) 1 MLJ 1, Privy Council decided though rental classified as income under s4(d), it could also fall under provisions of section 4(a), if received in the ordinary course of business. The said dealing must come within the ambit of section 4 or section 4A for it to be liable for income tax. In the case of *Dickson v Abel* 45 TC 353 court held that payments made as a gift not taxable on the receiver as it do not fall within the ambit of taxable sources .It is tax free because it is a capital receipt.

1.3 Research question

This study is going to look at the judicial interpretations substituting the *lacuna* created by the inadequacies of section 4 Income Tax Act 1967 in defining income.

The following questions will be proposed to be answered in this study:

- a) what are the problems arising from the brief description of income in section 4 Income Tax Act 1967?
- b) what are the situations which frequently knocks the judicial doors for the much needed guide as to what forms income?
- c) what are the classification of income judicially interpreted and decided by courts and other jurisdictions namely India and United Kingdom?
- d) what are the recommendations to be proposed to amend the relevant provisions namely section 4 Income Tax Act 1967 so as to cure the *lacuna*.

1.4 Objectives of the study

The objective of this project paper is to:-

- a) examine the problems arising from the brief description of income in section 4 Income Tax Act 1967;
- b) evaluate the many classification of income judicially interpreted and decided by courts and to compare with other jurisdictions namely India and United Kingdom;
- c) explain and give an understanding of income in revenue law and evolution of section 4 Income Tax Act 1967;
- d) suggest recommendations to amend the relevant provisions namely section 4 Income Tax Act 1967 so as to cure the *lacuna*.

1.5 Significance of the study

The study will give an insight to what actually constitutes income in relation to revenue law based on judicial interpretations as the Income Tax Act 1967 did not give a comprehensive meaning. The study will also involve discussion on current trend and policies in judicial interpretation with regards to the definition of income.

Suggestions and recommendations would be made namely to incorporate amendment to the relevant provisions generally and Income Tax Act 1961 specifically so as to remedy the lacuna. This paper is an attempt to give consolidated literature as to what falls under the ambit of income as the only guideline that we have is the judicial interpretations shading light unto the uncertain path.

The *lacuna* created by section 4 Income Tax Act creates uncertainty and ambiguity as it fails to define the meaning of income and leaves it to the judges to exercise their judicial creativity. The tax authorities would at first instance try their best to categorize all payment as income. The taxpayer on the other hand would deny the tax authorities' claims and argue that such payment arose from the disposal of capital assets, which include the loss of goodwill, and are within the ambit of capital receipt which is tax free.

One common argument of the taxpayer is that there is no express provision in the Malaysian Act to well define income. In the event of dispute it has to be resolved through tax appeal to the Special Commissioners. The tax authorities will generally have an upper hand at the first round of argument as income tax has to be paid

notwithstanding that an appeal is made to the Special Commissioners. As this legal battle will involve money namely income tax and legal costs to be paid and a long time frame approximately two to three years, the taxpayer will be at the losing end even if he wins the appeal eventually. His position will be worse if he were to lose the case.

1.6 Research methodology

The methodology employed in this study is doctrinal research. It is also referred to as pure legal or conventional research and it is mainly library based study. In so far as this project paper is concerned, conventional or traditional research method is mainly concerned with stating, interpreting, comparing or clarifying the existing laws in Malaysia with India and United Kingdom. The analysis will be made with points drawn from sources which relate to defining the term income in relation to revenue law. This study will also utilize a comparative research method with other jurisdictions namely India and United Kingdom. The underlying purpose of this comparison is to search for similarity and variance to understand the issues better.

In any comparative legal study, the researcher may find the similarities and dissimilarities between two situations existing within the same legal system.¹ A comparative study may also involve a study of problem, issue or question in one

¹ Anwarul, Yaqin. Legal Research and writing.(Kuala Lumpur: Malayan Law Journal, 2007)p.18

legal system and a comparison with the position as it may exist in some other legal system such as nature, principles, effect, scope of a specific legal issue.²

Research for this paper will be undertaken using primary sources namely statutes mainly Income Tax Act from Malaysia, India, United Kingdom and judicial interpretations in the form of case laws. The research also uses secondary sources such as textbooks, articles, journals, documents from websites. This is a qualitative research.

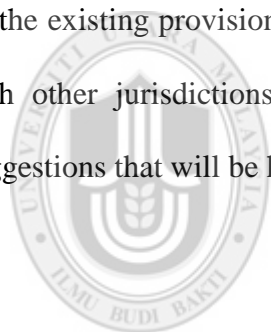
1.6.1 Research design

In general terms any research process involves a meticulous procedure of investigation, examining, evaluate, explore, explain and distinguish particular problem in detail by assistance of specific methodology or approach employed in the intermediate stage of data collection to the final stage of presenting the research findings. The methodology employed in this in this project paper would be qualitative research method. This will require through analysis, evaluate and describe both primary and secondary data that is accumulated from library based archives, such as textbooks, articles, journals, documents from websites.

² Ibid p.19

1.6.2 Scope of the study

Scope of the study focuses on the definition of income in Malaysia as provide in section 4 Income Tax Act 1967 and *lacuna* created due to the inadequacies which is now being substituted by judicial interpretations. The position is compared with two other jurisdictions namely India and United Kingdom. In order to appreciate and understand the research as a whole it is important to know the importance of section 4 in defining income as it forms the very foundation in determining the amount of tax levied and need to be paid by the taxpayers. That being the case the importance of tax and a comprehensive definition has been discussed by the researcher. The researcher than, will proceed to discuss on the current positions and problems created by the existing provision backed by case laws and proceed to compare then position with other jurisdictions. Lastly the researcher will also make recommendations suggestions that will be helpful in overcoming the problems.



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1.6.3 Types of data

In so far as this project paper is concerned two types of data will be used that is primary sources and secondary sources. Primary data refers to statutes mainly Income Tax Act from Malaysia, India, United Kingdom and judicial interpretations in the form of case laws be it reported in journals or otherwise. The research also uses secondary sources such as textbooks, articles, journals, documents from websites and other library based information. The nature of this research is that of legal study.

Legal research refers to systematic study of legal principles, concepts, rules, theories, doctrines, decided cases, legal institutions, legal disputes, legal problems, *lacuna*, issues, questions or a combination of some or all mentioned above. In this research qualitative method is employed in order to achieve its objectives through the use of doctrinal legal research methodology. A doctrinal research deals with the detailed analysis of existing legal doctrines, literature, statutes and case laws. It is mainly concerned with stating, interpreting or clarifying the existing law in certain jurisdictions. The researcher has to initially study the facts, principles, themes, concepts, relevant provisions and the laws on income tax namely with regards to definition of income as provided by section 4 Income Tax Act 1967 and make comparative study of the similar provisions in other jurisdictions namely in India and United Kingdom and proceed to explain, evaluate and compare.



1.6.4 Data collection method

The study in this research will be purely doctrinal legal research involving data collection style of both primary and secondary sources. The data gathered and presented here will be immensely valuable to the field of study and research design. The data will be derived from various sources such as website and library based materials such as books, journals, articles, legal doctrines, statutes, reports, previous thesis and dissertations and other relevant and related materials. The so collected data will be than evaluated critically and analyzed to extract the reliable information.

1.6.5 Limitation of the study

In process of this research, the researcher had to face certain limitations. Amongst the problems encountered whilst writing this research paper would be what to be omitted, excluded or left out. Apart from this there were also other problems encountered whilst completing this paper namely difficulty in finding related materials such as articles, books, reports or precedence in the form of earlier thesis or dissertation due to its scarcity and also due to its specific scope whereby the whole research in this project paper is centred on one specific section Income Tax Act 1967 that is section 4 defining income. This is an exploratory study where a lot of hard work has been invested for the purpose of collecting data namely by browsing the many case laws, examine and evaluate the data collected in relation to the research. The other problem encountered centre around collection of data namely statutes, provisions and articles to name a few from other jurisdiction especially so because the problem researched hereof is peculiar to Malaysian situation with not much similar scenario in other jurisdictions.

1.6.6 Analysis of data

In this study, the research applies analytical and critical analysis. An analytical approach involves meticulous examination and evaluation of the materials involved so as to understand, explain and draw a conclusion. Critical approach is distinct from analytical approach in that in critical approach, the researcher examines and evaluates the materials meticulously, list down the discrepancies and shortcomings, gives own opinion as to why the researcher agrees or otherwise based rational

grounds and supported by evidence and justifications. In this research both methods employed to examine the strength and discrepancies of section 4 Income Tax Act 1967 in defining income. That being the case, the relevant provisions under the statute be it in Malaysia and other jurisdictions are analyzed and criticized. It must also be emphasised here that this story will be a comparison between the provision for income tax defining income in Malaysia and other jurisdictions namely India and United Kingdom.

Conventional method will be employed in analyzing the sources both primary and secondary as it relates closely to legal study that identifies the related regulations and principles through meticulous examination of the relevant materials such as journals, articles, report and precedence.



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1.7 Literature Review

The main question here would be what constitutes income. Mere perusal of the statute, do not help one to understand what constitutes income. There is great gap left unfilled or undefined by the statute as to what forms income. Income Tax Act has given mere classifications of income without defining what actually forms taxable income, thus leaving everybody in a wild chase and has created lacuna. It is crucial to differentiate the two important notions of capital and income. The legislation imposes tax on income. There are no provisions to tax capital gains. The act do not define both income and also capital. The brief wording of the statutes creates problem for those who refers and rely on it such as the taxpayers as it fails to give a

clear picture. This creates problem namely for the taxpayers as they are uncertain what are the situation they can be compelled to pay tax. In that situation they have to go to court to seek clarification which again involve cost and time.

It is at this juncture that one need to knock on the doors of judiciary to shed light and to set the path right for those looking for the definition of income. The precedence clearly, non-exhaustive as the interpretation of what forms income is purely subjective and depends heavily on the circumstance and facts of each case. This is precisely what this paper set out to do, a compilation so to say for a one stop reference of income. This is an attempt to save time and agony for those looking for the definition and a working understanding of the same.

In Malaysia, in the famous case of *Mamor Sdn. Bhd. v Director General of Inland Revenue* (1981) 1 MLJ 117, Anuar J. commented at page 120:-

“... The object of the act is to tax income. The word income is not defined in the main Act. However not every gain, profit or earnings of the taxpayer is considered as income for the purpose of tax. By section 4 of the main Act only income is taxable. Such income however must be in the nature of gains and profits depending upon the sources of the receipts enumerated in para (a) to (f) of the section...”

In the same case of *Mamor Sdn. Bhd. v Director General of Inland Revenue* (1981) MLJ 117, Anuar J. went on and stated the following propositions of law:-

- a) In order for a transaction to be taxed as income, the nature of gains or profits has to fall into any of the section 4(a) to (f) Income Tax Act 1967.

- b) Not every gain, profit or earning of the taxpayer is income for the purpose of tax.
- c) One has to resort to case laws to explore the scope of income.
- d) A rigid or strict interpretation of the Act is required. Fairness or equity is never a consideration for the interpretation of the Act.

1.8 Organization of the paper

This project paper consists of five chapters. Chapter one is an introduction to the main issue addressed in this paper that is what constitutes income for purposes of Income Tax Act 1967. Second chapter discusses on classifications of income as per judicial interpretation. The third chapter discuss about the problems or lacuna created by Section 4 Income Tax Act 1967. Chapter four would be comparative study and analysis with other countries namely United Kingdom and India. Chapter five being the last chapter would be recommendations and conclusion.

CHAPTER 2

CLASSIFICATIONS OF INCOME AS PER JUDICIAL INTERPRETATION

2.1 Introduction

As stated in chapter 1 hereof, Malaysian income tax act merely mentions income without further clearly defining it. That being the case, perusal of the statute does not shade much light for one to understand what forms income. To understand what constitutes income it is crucial to differentiate the two important notions of capital and income. Income Tax Act 1967 do not define both income and also capital. That being the case one is left with no other alternative but to turn to courts for help in fill the gap left by the statute as to what forms income.

In the case of *Van Den Berghs Ltd. v Clark* 19 TC 390 Lord Macmillan at page 428 states that :-

“...The Income Tax Acts nowhere define “ income” any more than they define “ capital”; They describe sources of income and prescribe methods of computing income , but what constitutes income they discreetly refrain from saying...Consequently it is to the decided cases that one must go in search of light...”

Trying to differentiate capital and income is not an easy task. In the case of *Cir v British Samson Aero Engine Ltd.* (1938) 2 KB 482 at page 498, Greene MR commented:-

“...in many cases it is almost true to say that the spin of a coin would decide the matter almost as satisfactorily as an attempt to find reasons...”

Generally the issue of what constitutes income could be determined by looking into the facts of each given case by the reasonable man standard. Income has the characteristic of repetitive, flow from a source of income and received in the ordinary course of business. Income must also be evaluated from the perspective of the recipient. On the contrary, realisations from long term investment or personal assets are categorised as capital transactions and such a gain are termed as capital receipt.

Though judicial guidance does provide assistance to the meaning of income it is however never exhaustive. The merits of each case must be considered. In the case of *CIT Bengal v Shaw Wallace & Co.* (1932) 6 ITC 178 it was held that income connotes a periodical monetary return coming in with some sort of regularity, or expected regularity, from defined sources.

The source is not necessarily of one which is expected to be continuously productive, but it must be one whose object is the production of a definite return, excluding anything in the nature of a mere windfall. Windfall, gambling or profits arising from speculative activities are capital gains and would not be subject to income tax.

Similarly, cost saving too cannot be considered as income and thus not taxable. In the case of *FCT v Cooke and Sherden* (1980) 10 ATR 696 the court decided that if receipt of an item saves a taxpayer from incurring expenditure that saving is not income. Income is what comes in and not what is saved from going out.

The distinction between income and capital is a difficult one. In Malaysia, the principal was enunciated in the famous case of *Mamor Sdn. Bhd. v Director General of Inland Revenue* (1981) 1 MLJ 117. Though judiciary in this case held that the extraction and sale of timber in the course of developing the said land into oil palm plantation is capital, the Federal Court nonetheless reversed the High Court decision and held that the extraction and sale of timber fall into the ambit of section 4(a) Income Tax Act 1967 business income subject to income tax.

Upon further appeal to Privy Council, Lord Keith of Kinkel at the Privy Council, however, restored decision of Anuar J. and held that the timber in the course of oil palm plantation was a capital transaction. In the Lordship's view, the extraction of timber was inseparable from the process of developing the land as an oil palm plantation. Sale of the timber was a sound economic course to mitigate the cost of development, a capital expenditure.

The act imposes tax on income transaction, a pecuniary liability to taxpayer. The Act must be strictly interpreted. In this regard, in the landmark case of *Mamor Sdn. Bhd. v Director General of Inland Revenue* (1981) 1 MLJ 117, Anuar J. held:-

“...The SP Commissioner failed to show clearly that the proceeds was “income” of a type chargeable to tax and fitted into the relevant provisions. In law there is no room for presumption as regards to tax. In Cape Brady, Rowlatt J. Said “...in a taxing act one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about tax. There is no presumption as to tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language...”

As explained in the previous chapter hereof, in the case of *Mamor Sdn. Bhd. v Director General of Inland Revenue* (1981) 1 MLJ 117 among the legal proposition laid down by Anuar J. was that one has to resort to case laws to explore the scope of income. This is precisely what this Chapter 2 is all about. This topic discusses the situations or facts where courts have interpreted, defined, explained and categorised the many limbs of what can be considered as income and what is not for the purposes of tax. All the limbs or definitions so to say are extracted and evaluated from the many cases decided by the courts.

2.2.1 Intention of parties

It is important to determine the intention of parties as to whether it is long term investment or is it intention to trade as this help to determine if it is revenue or capital. In the case of *Alf Properties Sdn. Bhd. v Ketua Pengarah Hasil Dalam Negeri* (2005) 3 CLJ 936 Inland Revenue taxed Alf Properties for disposing part of land belonging to them which was not subject to development. Alf Properties appealed on the ground that the gains from disposal of the subject land was not assessable to income tax under section 4(d) Income Tax Act 1967 as being proceeds from disposal of capital assets as originally the land was purchased with intend for long term investment and not with intend to trade.

In annual returns it has always been shown under Land & Development Expenditure under fixed asset and not as current asset. ALF incurred development expenditure which is in confirmation with the original intention. No change of intention from

investment to trade from the time of acquisition to time of disposal. It's merely to realize an investment.

The main issue for Court Of Appeal to decide was whether the disposal of a portion of land belonging to Alf Properties to a third party purchaser known as Chenrai Investment Corp Berhad was disposal of a capital asset or disposal of stock in trade. In the case of *Lower Perak Co-Operative Housing Society Berhad v Ketua Pengarah Hasil Dalam Negeri* (1994) 3 CLJ 541 two guiding principles were enunciated:-

- i) Object of the company ; and
- ii) How the company treated the property in its account.

In determining the objects of the company it is important to refer to the Articles of Association and Memorandum of Association of the company. Intention of parties must be judged against the background of their acts and conduct in circumstances of the case. The question whether a profit realized on the sale of real estate is a realization or change of investment or an act done in the carrying on of a business is to be determined in the light of the facts of each case depending on the Articles of Association and Memorandum of Association of the company. The courts has repeatedly stated that objects in the AA & MA alone is not conclusive as they merely permit the carrying out of the objects stated therein as it is virtually not possible for the company to carry out all the objects.

To come to safe conclusion one has to refer to principal activity of the company, whether in the past or present. In *Bukit Yew Sdn . Bhd. v Director General Of Inland*

Revenue (1987) 2 CLJ 134 the court held that the proposed objectives of the company are relevant when considering the transaction in which the company is forced to have been engaged. It does not however follow just that because the company has power to do certain thing, anything done by the company must necessarily be carrying on business of the professed object of the company. In *Philip v West* 38 TC 203 it was held that whilst the 287 units of properties which the company build with the intention of selling ultimately was stock in trade of the business of builders, the 2,208 houses built for the purpose of lease were investments and any surplus arising from their sales was therefore not liable to tax and the company was not carrying on the business of property dealing.

In the case of *I. Investment Ltd v Comptroller General of Inland Revenue* (1975) 2 MLJ 208, Raja Azlan Shah FCJ (As His Highness than was) stated that it is important first to look at the nature and purpose of the company as expressed in AA & MA. It is important to determine the sort of business the company actually carries on and not what it start of to carry out or profess to carry out.

The acid test is to look at the nature and purpose and the substance of the transaction in question as expressed in its, MA and in doing so, one may go behind technicalities. So general rule, the mere setting up of a company points to its business intention because of its implied continuity. That would be a strong presumption that it intends to do business.

The judge further states that in dealing with income tax cases one must look at the surrounding circumstances not for the purpose of considering what one's own

conclusion might be, but for the purpose of seeing, in fact whether there is evidence both ways keeping in view what the company in fact did, the purpose for which it came into existence and the object which were prescribed in the MA and the whole of the circumstance. One has to examine the whole transaction before coming to a correct conclusion whether it is an investment. Look at the intention of the parties at the point of purchase whether to be kept for long term investment or whether it was purchased and to be resold at a profit as soon as possible or to be developed and to be sold in developed form and make profit from the transaction. If the property kept for investment would eventually be sold but the profit realized from the sale would be capital realization and not subject to tax.

Similarly in the case of *Ketua Pengarah Hasil Dalam Negeri v Promet (Langkawi) Resorts Sdn . Bhd.* (2011) 6 CLJ 829 the courts had to decide whether the proceeds of sale from land belonging to a business of owning and operating hotel and where disposal of land not in the course of seller's trading activities, taxable.

The respondent as registered owner sold 11 pieces of lands to Pakatan Permai Sdn. Bhd. for the purchase price of RM70,349,400 Pursuant to this sale, the appellant raised an assessment under the Income Tax Act 1967 against the respondent on the sale of the lands for RM27,234,648 The respondent appealed against the said assessment to the Special Commissioners of Income Tax (hereinafter referred to as "SCIT").

The reason for the sale was that the then Prime Minister requested the respondent to sell the subject lands to enable another luxury hotel to be developed in Langkawi.

Such a request had to be complied with. But for the request, the respondent would never have wanted to sell off part of its prime beachfront land. The respondent was clearly not in the business in land. The respondent's only business was and at all material times only that of owning a hotel. The issue submitted to the SCIT for determination was whether the proceeds from the sale of the lands should be charged with income tax under the Act or real property gains tax under the Real Property Gains Tax Act 1976 (hereinafter referred to as "RPGT").

The SCIT concluded that the gains on the sale of the 70 acres of the land were a capital realization and not subject to income tax under the Act. The SCIT unanimously allowed the appeal and ordered that the Notice of Assessment be discharged. Dissatisfied, the appellant appealed against the decision of the SCIT. Court held dismissing the appeal that except for the sale of the 70 acres, there was no evidence of any other transaction of other parts of the lands. There was uncontroverted evidence that the respondent had been and was still in the business of owning and operating the Tanjung Rhu Resort Hotel. The sale was upon a request by the then Prime Minister. Therefore it was not a sale initiated in any way by the respondent. On the evidence there was no intention by the respondent to sell. The SCIT had found that:

- (a) the investment in properties were made as a long term investment;
- (b) the appellant was not at any time trader in properties nor were the properties acquired as part of the appellant's trade;

(c) the investments were not undertaken as an “adventure in the nature of trade” for profit-making purposes. The sale of the subject land was a capital realization and therefore not subject to the ITA.

In the case of *Yong Mun Fook v Ketua Pengarah Hasil Dalam Negeri* (2001) 1 LNS 501 court decided that in order to decide whether proceeds from the sale of the subject land amounts to profits liable to tax under section 4(a) of Income Tax Act 1967, it is necessary to determine whether the income are profits of a trade or merely accretions to capital. The judge in the above case further quoted Whiteman on Income Tax - Third Edition - says at page 157:-

“Where the activities of a taxpayer in relation to the acquisition and sale of property are alleged to constitute the carrying on of a trade, it is necessary to determine, after consideration of all the facts of the case, whether the proceeds of sale are profits of a trade, or merely accretions to capital. In the Final Report of the 1954 Royal Commission six “badges of trade” were listed as being the relevant considerations in deciding whether a transaction of purchase and sale which has given rise to a profit is, or is not, to be treated as a trading transaction.”

Therefore, it becomes necessary to look for other factors to determine the dominant intention of the Appellant. Sharma J. in *NYF Realty Sdn. Bhd. v Comptroller of Inland Revenue* (1985) 1 MTC 234; (1974) 1 MLJ 182 came up with the following criteria for distinguishing between taxable and non taxable selling profits as being useful in determining whether a transaction amounts to a trading activity:-

(1) Subject matter of the transaction

Property which does not yield income or personal enjoyment to its owner merely by virtue of its ownership, and which is normally the subject of trading and rarely the

subject of investments, is more likely to have been acquired for the purpose of resale at a profit than property which does yield such income or enjoyment.

(2) Period of ownership

The fact that property is held for but a short time after its acquisition may tend to indicate that the purpose of acquisition was resale at a profit.

(3) Frequency of transaction

If there had been a number of transactions in the same kind of property it may be presumed that the taxpayer's purpose in purchasing the particular property was its resale at a profit.

(4) Alteration of property to render it more saleable

The fact that material alterations or improvements have been made to property or that its character or quality has been changed so as to render it more merchantable would tend to indicate that the property was derived from a profit making undertaking or scheme. However, if the property was clearly acquired for other purposes, extensive activities to render it more saleable after it is no longer useful for such original purposes would not cause any selling profit to be taxable.

(5) Methods employed in disposing of property

If special exertion is made to find or attract purchasers such as the opening of an office or advertising extensively, such facts tend to indicate the presence of a profit making undertaking. However, such facts would not of themselves cause the profit to

be taxable if the original purpose in acquiring the property was to use it rather than to resell it at a profit.

(6) Circumstances responsible for sale

If sale of property is occasioned by sudden emergency or unanticipated need for funds, in such an event facts will tend to indicate that the property was not acquired for the purpose of resale at a profit and that the sale was not pursuant to a profit making undertaking or scheme.

The fact that the nature of the asset lends itself to commercial transactions does not, without more, make it a trading activity. The subject land here was inherited and therefore requires much more to be classified as trading stock. In this respect, Lord President Clyde's test in *The Commissioners of Inland Revenue v Livingston* (1927) 11 TC 538 at page 542 would seem very appropriate:-

"I think the test, which must be used to determine whether a venture such as we are now considering is, or is not, "in the nature of "trade" ", is whether the operations involved in it are of the same kind, and carried on in the same way, as those which are characteristic of ordinary trading in the line of business in which the venture was made."

2.2.2 Sub division of land

Sub-division per se does not signify trading and it is important to enquire what was the purpose of the sub-division. If it is done for the purpose of rendering the land more saleable for purpose of trading it is done as land speculator. On the same accord, if a co-operative aim to pool its' financial resources of all its' members and with it purchase a plot of land with a view to satisfy their domestic need to each member to have roof over their head, then this would not necessarily signify a badge of trading.

2.2.3 Land owner entering into transaction with developer

Non commercial motivation may so affect the nature of trading transaction that they cease to be normal trading transaction and that a mere sale at a profit is not a trading activity. It would be wrong to assume that in every case where a landowner enters into a transaction with a housing developer, the landowner would be embarking on an adventure in the nature of trade. In the case of *Taylor v Good* 49 TC 227 Russell LJ states that:-

“...it seems to me the transaction points strongly against the theory of law that a man who owns or buys without present intention to sell land is engaged in trade if he subsequently not being himself a developer, merely takes steps to enhance the value of the property in the eyes of a developer who might wish to buy for development ...”

2.2.4 Company declaring the sale profit as profit and gains tax

This is about tax which is chargeable on income in respect of gains or profit from a business, for whatever period of time carried on. The word business defined in section 2 of Income Tax Act 1967 includes “profession, vocation and trade and every manufacturing adventure or concession in the nature of trade, but excludes employment. The broader question as to the meaning of adventure is the nature of trade would however be one of law.

In the case of *Thew v South West Africa Co. Ltd.* 9 TC 141 at page 156 it was held that it will constitute trading if profit which can be forced in the prices realized for land sold by this company are to be included in their profit and gains tax for income tax purposes. That depends upon whether the profits to be found in such sales are part of the profits of a trade or concern in the nature of a trade carried on by the company. A landowner who sells his land or in the case of a man with valuable possession who sells his books or pictures or plate or wine or what not, he would not be taxed for whatever enhanced value which he may make when he sells these articles as compared with when he bought them, for whatever their were worth at the beginning of the year, if he is merely selling his possession which he does not hold as a trade or with the view of a trader at all.

2.2.5 Intention of parties at the time of acquiring property

In the case of *Bukit Yew Sdn. Bhd. v Director General Of Inland Revenue* (1987) 2 CLJ 134 the court held that a good test to determine what the property held is investment or stock in trade is to establish the intention of the parties at the time of

acquisition of the property. In that case before World War 2, the object of the Trust was to retain Bukit Yew as part of the family inheritance and for sentimental reasons.

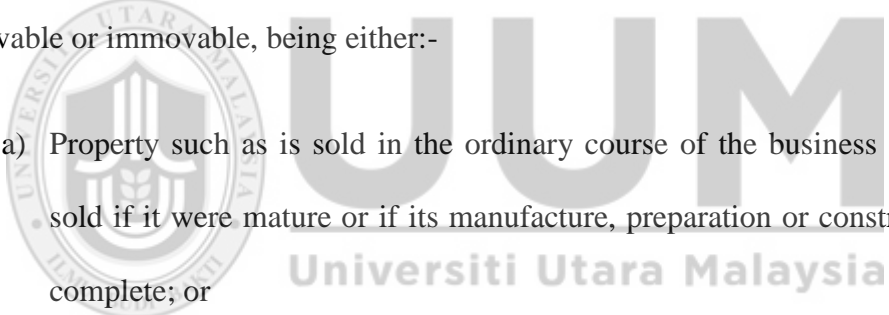
The court held that in that case the Special Commissioner over-emphasised this price difference and labelled it as profit to support their conviction of land dealing admitting of no other inferences. Trading requires an intention to trade at the moment of acquiring the property. The judge is of the opinion that it is not possible for the property to be both trading stock and permanent investment and at the same time for it to possess an indeterminate status.

In matter where a plain land has been converted into land ready for development, the character of land as originally purchased had changed. This must be viewed with the principal activity of the company which is that of property development. This plays a role in ascertaining the activity of the company as indicated by the case of *Taylor v Good* 49 TC 227 whereby it was stated that merely takes steps to enhance the value of the property in the eyes of a developer who might wish to buy to develop the company principal object is that of property development the position of the company would be different. The company ought to be aware that a company which describes its business as property development or itself as property developer or the company carrying on the business of property developer for sale and not for investment or for both. Any transactions to realize capital assets the proceeds of which are subject to payment under Real Property Gains Tax 1976.

2.2.6 Assets enhancement and stock in trade

In the case of *Lower Perak Co-Operative Housing Society v Ketua Pengarah Hasil Dalam Negeri* (1994) 2 MLJ 713, Edgar Joseph J. states that merely improving the value of land by clearing it, carrying out all necessary surveys sub- dividing it, constructing roads, drains, installing water & electricity to render it saleable (or more saleable) in regard to a single transaction to sell at a suitable pre-selected time or in certain circumstances, does not warrant the same definite conclusion as regard trading or even that the transaction is in the nature of trade. In such situation, in no sense does the land become part of the raw materials of trade, trading stock.

Stock in trade in relation to a business means property of any description, whether movable or immovable, being either:-

- 
- a) Property such as is sold in the ordinary course of the business or would be sold if it were mature or if its manufacture, preparation or construction were complete; or
 - b) Materials such as are used in the manufacturing, preparation or construction of any such property as is referred to in paragraph (a) of this definition, and includes any work in progress. If a company is to acquire an asset or trading stock, the asset must not only be of a kind which is sold in the ordinary course of the company's trade but must also be acquired for the purpose of that trade with a view to a resale at a profit.

Further, in the case of *Lower Perak Co-operative Housing Society Bhd. v Ketua Pengarah Hasil Dalam Negeri* (1994) 2 MLJ 713, Edgar Joseph J. cited with

approval the case of *Hudson's Bay Co Ltd. v Stevens* (1905) 5 TC 437 where Farwell

L.J. said:-

“A land owner may lay out part of his estate with roads and sewers and sell it in lots for building, that he does this as an owner, not as a land speculator... It would be different if a land owner, an individual, entered into the business of buying and developing and selling land; but the case of the owner, whether of land, or pictures, or jewels, selling his own property, although he may have expended money on them in getting them up for sale, is entirely different; he sells as owner, not as trader....”

2.2.7 Money withdrawn from partnership

In the case of *Suasana Indah Sdn. Bhd. v Ketua Pengarah Hasil Dalam Negeri* (2006) CLJ 165 Court of Appeal had to decide whether the income, particularly the monies withdrawn upon the dissolution of a partnership or cancellation of joint-venture agreement considered as income. The test is whether the agreement that is cancelled or terminated "is related to the whole structure of the company's profit-making apparatus" which is a test of the nature and effect of the agreement and not a test of the consequences of its cancellation or termination. If the agreement is related to the whole structure of the profit making apparatus of the company, then money that is paid on account of the cancellation of it, is capital, and if the agreement is not so related then the money is income, and that is so irrespective of whether the cancellation or termination of the agreement destroys the company's business.

In the case of *Ketua Pengarah Hasil Dalam Negeri v James Armend Menezes* (2001) LNS 1 183 the court had to decide whether the amount received by way of settlement under partnership agreement is capital rather than income for purposes of income

tax. The Respondent James an accountant had been a partner of the accounting firm Ernst & Whinney since 1st July 1981. Subsequently when Ernest & Whinney decided to merge with another accounting firm, Ernst & Young (Malaysia) the Respondent together with 2 other partners of Ernst & Whinney objected. Despite the objection the merger between the two accounting firms went ahead. The merger came into effect on 1st July 1990. However a settlement was reached between Ernst & Whinney and the three opposing partners including the Respondent.

The court affirmed the Special Commissioners decision that the payment was in fact capital payment instead of income. In arriving at the decision the Special Commissioners gave the following reasons:-

1. The sums paid are withdrawal of capital in respect of goodwill upon retirement;
2. The consideration received was for loss of rights under the Deed dated 1st September 1981;
3. Payments received were in consideration for refraining from competition with accounting firm.

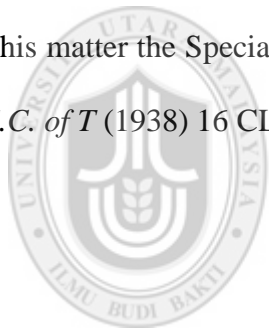
In arriving at the decision that such loss of rights was capital received the Special Commissioners referred to the case of *Van Den Berghs v Clark (H.M. Inspector of Taxes)* 19 TC 390 quoting the judgment of Lord Macmillan, as follows:-

“In my opinion that asset, the congeners of rights which the Appellants enjoyed under the agreements and which for a price they surrendered, was a capital asset.”

The court in arriving at the decision fully adhered to the principles enunciated by Lord Russel in the case of *Commissioners of Inland Revenue v Fleming & Co.(Machinery Ltd.)* 33 TC 57, where His Lordship said:-

“The sum received by a commercial firm as compensation for the loss sustained by the cancellation of a trading contract or the premature termination of an agency agreement may in the recipient’s hands be regarded either as a capital receipt or as a trading receipt forming part of the trading profit. It may be difficult to formulate a general principle by reference to which in all cases the correct decision will be arrived at since in each case the question comes to be one of circumstances and degree.”

The Special Commissioners further said that, payment received by the Respondent to refrain him from competing with the partnership business was capital. And in support of this matter the Special Commissioners referred to the case of *Sun Newspapers Ltd v F.C. of T* (1938) 16 CLR 337.



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2.2.8 Compulsory acquisition of land by government

In the case of *Ketua Pengarah Hasil Dalam Negeri v Penang Realty Sdn . Bhd. & Others* (2006) 2 CLJ 835, the court held that compulsory acquisition by government could be considered as the taxpayer trading in the land. To decide whether the profits derived from the sale of the houses by the taxpayer shall be taxable, two issues had to be ascertained:-

- a) whether the sale of the houses built by the taxpayer, was a realization of it’s investment, thus rendering any profits derived from the transaction not subject to tax ;or

- b) was the disposal in the course of its business thus rendering the profits subject to payment of income tax and whether the element of forced sale was present in the tax payer disposal of the units.

In this particular case, the court of appeal held that forced sale cannot constitute a sale the proceeds of which are subject to tax because the element of compulsion vitiates the intention of trade.

The same principle was discussed in the case of *Lower Perak Co-operative Housing Society Bhd. v Ketua Pengarah Hasil Dalam Negeri* (1994) 2 MLJ 713 where Edgar Joseph Jr. SCJ endorsed the taxpayer's contention that a forced sale cannot constitute a sale the proceeds of which are subject to tax because the element of compulsion vitiates the intention to trade.

However, the courts decided otherwise in the case of *F. Housing Sdn. Bhd. v Director- General of Inland Revenue* (1976) 2 MLJ 183 where land belonging to the appellant company had been acquired by the government. Compensation in the sum of \$1,407,139.69 was paid to the appellant company and tax was assessed on the difference between this and the purchase price of the land. The question for determination was whether the difference between the compensation awarded and the purchase price was assessable to income tax under section 4(a) of Income Tax Act 1967.

The High Court held that on the facts of that case, the isolated transaction, although it concerned compulsory acquisition, should lawfully be regarded as a trading

transaction and therefore the difference between the acquisition award and the purchase price and cost of the land was income in respect of gains or profits from a business within the meaning of section 4(a) Income Tax Act 1967 and liable to tax.

In the case of *Lower Perak Co-operative Housing Society Bhd. v Ketua Pengarah Hasil Dalam Negeri* (1994) 3 CLJ 541, Edgar Joseph Jr. in his grounds at page 749 states:-

“We consider that for all practical purposes the taxpayer had no choice but to sell to the developer in view of the predicament in which it found itself. The particular circumstances of that predicament may be taken from the facts as found by the special commissioners in their case stated and, it will be recalled were as follows:-

(xxiii) after the signing of the supplementary agreement (D), demand for houses by the appellant’s [the taxpayer] members slackened due to dissatisfaction with the houses erected; in spite of the appellant [the taxpayer] relaxing its rules regarding payment of a deposit before booking for a lot by potential member purchasers, 41 lots with houses built thereon out of 111 lots were not taken up;

(xxiv) by this time the appellant [the taxpayer] became aware that it had to incur a lot of expenses to carry out its obligations as provided in the agreements; appeals were made to the developer to revise the terms of the agreements but the developer rejected such appeals;

(xxv) the developer informed the appellant [the taxpayer] that since the appellant [the taxpayer] could not get purchasers for the remaining 41 houses, the appellant [the taxpayer] had to construct the infrastructure which the appellant [the taxpayer] was obliged to do ... ; the appellant [the taxpayer] estimated the cost to be another RM100, 000; relations between the parties became strained...”

We consider that the sale in the present case was brought about and necessitated by supervening events, namely, the particular circumstances giving rise to the predicament aforesaid and the inability of the taxpayer to raise funds from banks or financial institutions to finance its housing project of which the beneficiaries were its members.

The finding of the special commissioners that there was some element of forced selling of the subject lots' and the further finding that the object of the appellant (taxpayer) in acquiring the land was to develop it and sell the lots to its members but because of circumstances beyond its control it could not sell all the lots to its members and hence had to sell the subject lots in dispute to a non-member namely the developer, were findings which were amply justified by the evidence. Unfortunately however, the special commissioners failed to recognize the significance of these findings in the context of the taxpayer's contention that a forced sale cannot constitute a sale the proceeds of which are subject to tax because the element of compulsion vitiates the intention to trade.

2.2.9 Gift

In the case of *Dickson v Abel* 45 TC 353 court held that payments made as a gift not taxable on the receiver as it do not fall within the ambit of taxable sources .It is tax free because it is a capital receipt.

However the position were different in the case of *Yii Chee Ming v Teo Ah Khing & Anor* (2007) 4 CLJ 79 . In this case the courts defined use of the word gifts to an act of giving unsupported by valuable consideration. In this case the defendant one Mr. Teo in his statement and oral testimonies stated that the gifts were in consideration of his services to the plaintiff and his family companies. That being the case the defendant expected his services to be compensated. The defendant tried very hard to differentiate his personal services and that of his company. With respect, the courts

found that there was no difference between the two for the simple reason that the services he or his company provided to the plaintiff related to his professional work, with the aim of enhancing the worth of plaintiff and his family companies.

Further, looking at section 4(a) and (b) of the Income Tax Act 1967 clearly shows that the gifts for service rendered by the defendant would be taxable. Payments for the services rendered by defendant were paid for with a foreign property and that did not make the gift less taxable.

That being the case, the fact that the defendant did not declare the gifts as income corroborated the plaintiff's assertion that the foreign property and shares were not mere gifts. Furthermore, it did not make business sense for plaintiff to personally give the foreign property and company shares to defendant as mere gifts. It is only logical for any accountant to ensure that whatever gifts given to the defendant would be tax deductible, which could be done by channelling the gifts through plaintiff's family companies as legitimate.

As such, the predominant question one need to ask when it comes to gifts would be act of giving unsupported by valuable consideration.

2.2.10 Dividend

In the case of *TSB v KPHDN* (1996) 2 BLJ 403 the courts had to determination whether the nine units of shop houses received as a dividend by the appellants and

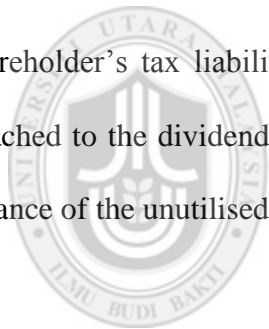
taken as stock-in-trade immediately upon their receipt should be valued at the gross amount of the dividend of RM6,666,667 or at the market value of RM4,000,000.

In the dividend certificate issued, it was certified that tax deducted or deemed to be deducted from the dividend has been or will be duly accounted for to the Director-General of Inland Revenue. The market value of the shop houses at the time of distribution was RM4,000,000. None of the shop houses were sold during the basis period for the year of assessment 1978 although bookings were received in December 1977.

Generally, when a company has made a profit, it may decide to distribute part of all of its profit in the form of a dividend to its shareholders. A matter that arises of consideration is whether the dividend can be in any form other than cash. This point arose in *Rae v Lazard Investment Co. Ltd.* 41 TC 1, where it was held that if an existing property development company decides to distribute completed houses to its shareholders, this would be a distribution in specie and taxable as dividend income of the shareholders. In *Pool v Guardian Trust Co. Ltd.* 8 TC 167, the company was required by the anti-trust laws of the USA to dispose of its shares in subsidiary company. It was decided to do so by distributing the shares in specie to its shareholders. At the same time, the company announced that it would be reducing henceforth its rate of ordinary dividend by the amount which would yield income to the shareholders by the distributed shares in the subsidiary company.

In Malaysia, the term dividend is specifically mentioned in section 4 of the Income Tax Act 1967 although there is no definition of it. In so far as Malaysian position is

concerned, the full amount of income tax paid by a company is imputed to the shareholders. The object of the imputation system is to mitigate or eliminate the double taxation of corporate profit i.e. the said profits are taxed at the company level again, as dividends, on the shareholders. The mechanism by which this is achieved is by granting companies the power to impute income tax paid on corporate profits to any dividends paid, credited or distributed to shareholders. In other words, the corporate tax is regarded as advance tax paid by the shareholders. The imputation of the corporate tax will be in the form of tax credits attaching to the dividends. The shareholder will be assessed not only on the dividend received or credited but also on the amount of the imputation credit attached to the dividend. Therefore, the shareholder will be charged to tax on the gross amount of the dividend. The shareholder's tax liability is then reduced by the amount of the imputation credit attached to the dividend. In the event the tax liability is less than the tax credit, the balance of the unutilised tax credit is usually refunded to the shareholder.



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Section 2 Income Tax Act 1967 defines market value to mean the price which an item would fetch if it is sold in a transaction between independent persons dealing at arm's length. In *BSC Footwear Ltd v Ridgeway* 47 TC 495, the market value of stock was held to be the best price obtainable in the market in which the trader actually sells. Thus, for a retail trader, it means the retail price and not the wholesale price.

In the local case of *DGIR v LCW* (1975) 1 MLJ 250 it was established that when an asset is appropriated from fixed asset to stock-in-trade, the value of the stock-in-trade is its market value at the date of appropriation and not the original cost of acquisition

as a fixed asset. The market value at the date of appropriation is the cost to the business. Lee Hun Hoe CJ stated:-

“...The proviso to s 35(3)(a)(i) refers to “its cost price to the relevant person.” Account must be taken of s 35(1). “Relevant person” seems to indicate a person in relation to his business. The cost price referred to by the proviso would mean the cost to the business of that person, that is to say, the value of the land at the time of appropriation in 1963. The true value to the business is the market value in 1963 and not the original value in 1953. The proviso is a codification of accepted accounting principle in business or commerce. Any computation of profits which is contrary to accepted principles must be regarded as unreasonable. When respondent converted his capital assets into stock-in-trade and started dealing in them the taxable profit on the sales must be determined by deducting from the sale proceeds the market value of the assets at the date of conversion into stock-in-trade since that is the cost to his business and not the original cost to him...”



2.2.11 Sale of shares

In the case of *PUSB v Director General Of Inland Revenue* (1995) BLJ 4 281 the question for the determination by the Special Commissioners is whether the gains from the sale of 1,290,000 shares held by the appellant in Sarawak Motor Industries (SM 1) are chargeable under section 4(a) of Income Tax Act 1967.

The Courts have laid down various guidelines or tests to distinguish gains arising from the disposal of an investment and gains arising from a business or trade or an adventure or concern in the nature of trade, notably in the case of *Leeming v Jones* 15 TC 333, *E v Comptroller of Inland Revenue* (1970) 2 MLJ 117 and *NYF Realty Sdn. Bhd. v DGIR* (1974) 1 MLJ 182. They are:

- (1) Subject matter of the transaction;
- (2) Period of ownership;
- (3) Frequency of transaction;
- (4) Alteration of property to render it more saleable;
- (5) Methods employed in disposing of property;
- (6) Circumstances responsible for sale;

In this case *PUSB v DGIR* (1995) 4 BLJ 281 after the purchase of the shares SMI expanded its activities and acquired interest in 6 timber companies and 2 realty companies. Thus, from a company assembling car parts it had expanded into timber and landed property business. At that time the timber industry in Sarawak was a premier revenue earner and so by expanding its activity to other industries particularly the timber industry this added premium to the value of SMI shares and making them very attractive in the share market. Likewise housing and building development were also on the rise and were profitable ventures especially it's Simpang Tiga Land in Kuching.

Any profit made out from such transaction is plainly an income derived from trading activity or an adventure in the nature of trade. More crucial is there was no evidence to show that the shares were sold because of any sudden emergency or unanticipated need for fund. The sale was anticipated. It was a conscious move so that the proceeds may be unutilised to set-off the interest and loan fast and thus leaving the balance as

profit. It may argued, that the sale was necessitated because of the need to pay the debt within a year. But the evidence did not support him in this case because there was no evidence to show that he had sold enough to settle his debt and interest. He only sold a portion which was insufficient to cover his debt although he could have done so. In fact at the price of RM3 per share which is twice the amount that he paid for in acquiring the shares he could have disposed off only three-quarters of the original shares and still could make a profit. This he did not do but instead he waited and sold only a portion and speculated with the rest. Over the same case Sharma J stated:

“...The question of what the intention of a taxpayer was when he acquired an asset i.e. whether he bought it as an investment or with a view to selling it at a profit, is a question of fact. It has to be determined by inference from proved facts and such an inference is one of fact and not of law...”

In PUSB they sold the SMI shares a few months after the purchase in order to settle the bank loan which was taken to finance the purchase of the said shares and had hoped to dispose of the rest when the market was right.

Finally there is another factor which ought to be taken into consideration and that is on how the party kept their account on these shares. Although it is often stated that the way the assets are treated in the financial account is not decisive in determining the capital or income nature of an asset it cannot be denied that the treatment is an important factor.

In the above case it was admitted by appellant that it was part of their objective as an investment company to buy and sell shares. The buying and selling thus become the

integral part of the business of PUSB and the profit arising of the sales will thus be of course be an income character. This case is likened to that of a bank or an insurance business company where stocks and shares bought in hand are subsequently disposed of in order to finance repayment to depositors. In the instant case there is no difference i.e. the sales proceeds were to service the bank loan. Shares are also treated as trading stock of the bank or insurance business.

The way SMI shares have been treated in the company's account is not decisive in determining the capital or income nature of an item. In the case of *John Smith and Son v Moore* 12 TC 282, if PUSB's contention can be accepted that the gains were fixed capital gains then rightly the account should have reflected as capital gain not available for distribution. Since the gains are available for distribution it only strengthened the Inland Revenue's contention that the profits came from the business transaction of PUSB. Another criterion which had been used by the Courts in establishing whether a company is carrying on a commercial deal or not was elaborated in *Leeming v Jones* 15 TC 333 where it was held that even an isolated purchase of a complete cotton spinning plant could be a trading activity and chargeable to tax if the disposal of it had to be in five separate lots over a period of time. The facts in this case have indicated clearly that there were sufficient badges of trade to hold PUSB in making the one purchase of the one million shares and making six re sales of these shares as carrying on a commercial deal or a business or an adventure in the nature of trade, and the profit in excess of RM400,000 arising there from, after deducting a loss, is liable to tax.

2.2.12 Interest earned from short term and long term deposit

In the case of *Ketua Pengarah Hasil Dalam Negeri v Pan Century Edible Oils Sdn. Bhd.* (2002) 3 CLJ 784 the issue for determination in this case was whether the interest income of the respondent derived from short term and long term deposits was business income under section 4(a) or interest income under section 4(c) of the Income Tax Act 1967. The effect of this classification was pertinent because by reason of section 43 of the Act, adjusted losses from a business of a taxpayer for previous years of assessment could be set off from a source consisting of a business under section 4(a) but not against income from any other source. Before the Special Commissioners of Income Tax, the appellant contended that the interest income fell under section 4(c) as it was clearly interest and not gains or profits from a business. On the other hand, the respondent contended that the interest income was part and parcel of its business income or ancillary to its business or it was business income arising out of an adventure or concern in the nature of a trade and therefore within section 4(a). The Special Commissioners classified the interest income as business income under section 4(a) and that was affirmed by the learned judge on appeal. The appellant appealed to court of appeal.

The court held in confirmation with Privy Council decision in the case of *American Leaf Blending Co Sdn. Bhd. v Director-General of Inland Revenue* (1979) 1 MLJ 1 that despite the fact that interest was referred to in section 4(c) of the Act, it nevertheless constituted income from a source consisting of a business if it was receivable in the course of carrying on a business of putting the excess cash to profitable use by placing it on short term and long term deposits.

2.2.13 Rent received from letting out factory building

In the case of *GDPDFSB v Director General Of Inland Revenue* (1996) 1 BLJ 7 court had to decide whether the rents received from the letting out of the appellant's building (factory building) constituted income from a business within the meaning of section 4(a) of the Income Tax Act 1967 or rental income under section 4(d) of the same Act.

The objects of the appellant as listed in its memorandum and articles of association are, inter alia, purchasing and letting out moveable and immovable property of all kinds, in particular lands, building and hereditaments. The appellant started letting out its factory building in December 1978. It was contended that the said rents constituted income from a business within the meaning section 4(a) of the Income Tax Act 1967 on the grounds that under its memorandum and articles of association the appellant is given the authority to deal with its property in whatever way profitable to its shareholders. So it started with the batik printing business and later put the factory building to profitable use by letting it out for rent. The appellant is a company formed to make profits for its shareholders and is not an individual. Any gainful use to which it puts any of its assets prima facie amounts to carrying on of a business.

The court held that the rents received from the letting out of the appellant's factory building for the relevant years of assessment constituted income from a business within the meaning of section 4(a) of Income Tax Act 1967.

2.3 Conclusion

The examples listed above are just a few frequent scenarios that catch the courts' attention and the list goes on but one issue remains salient in almost all the decisions and that being the intention of the parties, the circumstances surrounding the matter and conduct of the taxpayers. Though it is agreed that the test is generally subjective but in the eyes of justice it succumbs to the Intention test. As for matters relating to company and business it is important to ascertain the objectives incorporated in the articles and memorandum of association.

In the case of *Ketua Pengarah Hasil Dalam Negeri v Perbadanan Kemajuan Negeri Johor* (2009) 5 CLJ 518 the court of appeal stated that it is essential to hark back to the simple and basic rule that income tax is a tax on income. Where there is no income, there can be no liability to tax, in which case no question of exemption can ever arise. Exemption is only relevant when there is chargeable income but not otherwise. A tax exemption is only given after liability to tax has been determined. It therefore follows that the word income means necessarily chargeable income and hence tax exemption is given at the chargeable income level.

CHAPTER 3

PROBLEMS ARISING FROM INEDUQUACIES OF

SECTION 4 INCOME TAX ACT 1967 IN DEFINING INCOME

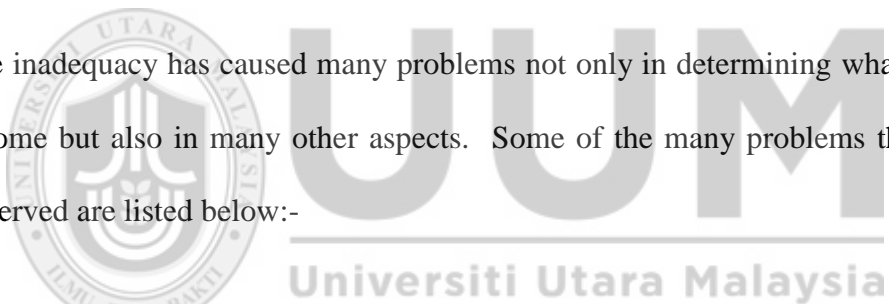
3.1 Introduction

In the previous chapters of this project paper ample discussion made on what is tax and that tax can only be imposed on income. To be able to ascertain that, one need to clearly identify what constitutes income. In Malaysia, income is defined in section 4 of Income Tax act 1967 albeit very briefly. In chapter 2 hereof we have seen that to substitute the *lacuna* left by section 4, the courts has always actively played their role in defining what are the source that could be considered as income for purposes of tax based on the facts of each given case. In the process the courts has so to say, accumulated number of limbs or classifications of income. Though the court has filled in the gap left by the drafter be it intentionally or otherwise, it do not go without problems. The inadequacies of section 4 Income Tax Act 1967 in defining income though substituted by judicial interpretation, remains a problem to be solved.

The problems could be gathered from looking at the number of cases knocking the courts doors for assistance and the lengthy decisions written to justify why in certain given facts courts classify it as income and vice versa. In this topic most of the problems pen down are extracted from reading the many case laws decided by court on issue of income and also from an article written by Mr. Choong Kwai Fatt, Tax Consultant and lecturer titled “Compensation In Connection With Business Receipts-

An Analysis Of The Malaysia Experience” (2002) MLJ xix (Hereinafter referred to as the “the article”). Though the article focuses directly to business receipts, the problems, solutions and recommendation explained applies across the board and specially so for this project paper. The author acknowledges the problems in section 4 where he says “...section 4(a) specifically governs business income”. The tax net is on “business income” and capital receipts are tax free. Since the Malaysian act fails to define the meaning of “gains or profit” and leaves it to the judges to exercise their judicial creativity in laying down its boundary...”. At this juncture it is important to give credit to Mr. Choong Kwai Fatt for a considerable portion of discussion in this topic has been extracted from his article.

The inadequacy has caused many problems not only in determining what constitutes income but also in many other aspects. Some of the many problems that could be observed are listed below:-

- 
- a) uncertainty on part of tax payer as there is no clear definition ;
 - b) judicial interpretations are the only clue to substitute the inadequate definition;
 - c) ambiguity as there is no clear criteria;
 - d) Needs extensive proving such as calling accountants and other witnesses ;
 - e) No clear demarcation between revenue and capital ;
 - f) Each fact needs to be decided on its own facts as it's substantive and subjective;
 - g) Time consuming and thus waste of judicial time;

h) Expenses or cost in defending the suit.

For the purpose of discussion, though the problems have been categorised separately to show the magnitude, the explanations will be done conjunctively except for a few so as not to seem repetitive as really all the problems though individual in their characters they sit in the same space.

3.1 Problems

In practice the tax authorities generally would at the first instance categorize all payments as income whereas the taxpayer on the other hand would dispute the claim generally on the basis that such payment was disposal of capital assets which include the loss of goodwill and thus should be free of tax. The dispute has to be resolved through tax appeal to the Special Commissioner who would decide based on the facts involved and law of tax. The unhappy party later would appeal the matter to High Court and Appeal to Court of Appeal. But by then the tax authorities would have better say at the first level of argument as the tax has to be paid notwithstanding that an appeal is made. As this battle involve money both in terms of income tax and legal cost and time consuming where the dispute may take 2 to 3 years to be decided the tax payer would obviously be on the losing end. Even if the taxpayer were to win the case in business sense and time he would have actually suffered loss.

Further in tax appeal, the taxpayer has to pass through another hurdle of preparing the evidence both oral and documentary as the law places the onus of proving on the

tax payer. To date there is no clear line demarcating capital and revenue receipt (business income).

3.2.1 Each case needs to be decided on its own facts

Each case must be decided on its facts. To decide on facts, involves lengthy trials, brief needs to be prepared which is time consuming and it involves calling of witnesses. Mac Dermott LCJ in *Harry Ferguson (Motors) v IRC* 33 TC 15 at page 42:-

“...There is so far as we are aware no single infallible test for settling the vexed question of whether a receipt is of an income or capital nature. Each case must depend on its particular facts and what may have weight in one set of circumstances may have little weight in another...One has to look to all the circumstances and reach a conclusion according to their general tenor and combined effect...”

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Further, in the case of *Barr, Crombie & Co. Ltd. v Commissioner of Inland Revenue* 26 TC 406, at page 411 Lord President Normand stated that :-

“...It has been truly said that every case must be considered on its own facts and that no legal criterion for distinguishing between capital payments and income payments is readily available...”

3.2.2 Needs extensive proving including calling of witnesses

As discussed earlier one of the direct problem or inconvenience resulting from the inadequacy of section 4 Income Tax Act 1967 can only be solved by courts

by interpretations and for that the disputes must be tried in full hearing which involves calling of witness such as accountants and directors as more often than not the disputes involves subjective issues like intention of parties amongst others.

In *I. Investments Ltd. v DGIR* (1975) 2 MLJ 208 at page 212, Raja Azlan Shah F.J. (as he then was) referred to a passage from the judgement of Lord Denning in *Heather v P.E. Consulting Group Ltd.* 48 T.C. 293 at page 322:-

“...The courts have always been assisted greatly by the evidence of accountants. Their practice should be given due weight: but the courts have never regarded themselves as being bound by it. It would be wrong to do so. The question of what is capital and what is revenue is a question of law for the courts. They are not to be deflected from their true course by evidence of accountants, however eminent...”

Further, Rowlatt J. in the case of *Bernhard v CIR* 13 TC 723 at page 735 said:-

“... Income Tax does not necessarily follow the system of accounting or account-keeping of the taxpayer at all...”

In this respect, reference should also be made to *Bukit Yew Sdn. Bhd. v Director General of Inland Revenue* (1987) 2 CLJ 134, Harun J. (as he then was) said at page 382:-

“...The way in which a company keeps its accounts may be evidence of the company’s intention but such evidence must be weighed against other evidence to decide the nature of the transaction: Shadford (HM Inspector of Taxes) v. H. Fairweather 43 TC 291...”

Further, Lord Hanworth MR. in the case of *The Seaham Harbour Dock Company v Crook* 16 TC 333 at page 347 stated that:-

“...the mere mode of payment or method of accounting does not alter the character of the sums received ...”

Lord Guest stated in the case of *Duple Motor Bodies Ltd. v Ostime* 39 TC 537 at pages 573 and 574:-

“...It can never rest with the taxpayer to decide upon what principle his income is assessed for tax purposes. The directors’ decision can never be decisive of the matter for Income Tax purposes... The assessment, in addition to being consistent with normal accounting practice, must be made according to the provisions of the Income Tax Acts...”

Further to that, Lord Porter in *Ryan (H.M. Inspector of Taxes) v Asia Mill Ltd.* 32 TC 275 at page 296 said:-

“...Moreover what may be prudent accountancy for a company is not necessarily the correct method of ascertaining the proper assessment for Income Tax...”

In this respect, reference may be made to *Simmons v IRC* (1980) 1 WLR 1196, Lord Wilberforce said:-

*“...One must ask, first, what the commissioners were required or entitled to find. Trading requires an intention to trade; normally the question to be asked is whether this intention existed at the time of the acquisition of the asset. Was it acquired with the intention of disposing of it at a profit, or was it acquired as a permanent investment? Often it is necessary to ask further questions: a permanent investment may be sold in order to acquire another investment thought to be more satisfactory; that does not involve an operation of trade, whether the first investment is sold at a profit or at a loss. Intention may be changed. What was first an investment may be put into the trading stock, and, I suppose, vice versa. If findings of this kind are to be made precision is required, since a shift of an asset from one category to another will involve changes in the company’s accounts, and, possibly, a liability to tax of *Sharkey (Inspector of Taxes) v. Wernher* (1955) 2 All ER 493; (1956) AC 58. What I think is not possible is for an asset to be both trading stock and permanent investment at the same time, nor for it to possess an*

indeterminate status, neither trading stock nor permanent asset. It must be one or the other, even though, and this seems to me legitimate and intelligible, the company, in whatever character it acquires the asset, may reserve an intention to change its character. To do so would, in fact, amount to little more than making explicit what is necessarily implicit in all commercial operations, namely, that situations are open to review...”

The intention must be shown to have existed at the time of the acquisition of the subject lots and the intention of the Appellant must be judged against the background of its acts and conduct and the circumstances of the case. Intention is a substantive and factual issue which could be established only by oral evidence of witnesses which is time consuming.

3.2.3 No clear demarcation between revenue and capital.

It is important to establish the difference between revenue and capital because one is considered as income and taxable whereas the other is not. This important difference not incorporated into section 4 of Income Tax Act 1967.

The compensation or disposals generated from realization of fixed capital (sometimes also known as capital asset) are capital receipts. Fixed capital are assets owned by the company which is used to facilitate the running of the business which includes factories, plants, furniture and fittings, buildings and machinery used in a business. An eminent economist, Adam Smith, in his book “The Wealth of Nations” distinguished fixed capital from circulating capital as:

“...Something the owner makes a profit from by retaining ownership, whereas circulating capital is something that realizes profit by letting it change owners...”

Circulating capital comprises of goods sold or services provided by a business to its trade customers with intention of profit making. It also refers to trading stocks in which ownership and risk passes on to its' customers for a profit. Any sum received from the disposal or destruction of circulating capital is revenue, which constitutes income.

Capital assets may include intangibles such as a restrictive covenant entered into by a trader or a professional for monetary consideration. In *Higgs v Olivier* 33 TC 136 an actor entered into an agreement with a film company that restrained him from acting in any films for 18 months. He received £15,000 as consideration. This was held by the Court of Appeal to be a capital. The court was of the opinion that such a restrictive covenant is akin to a trader selling the capital assets of the trade and therefore such receipt is capital in nature. The receipt was not a receipt of the actor's trade as he has given up a 'right to act' for a consideration.

In *Paget v Commissioners of Inland Revenue* 21 TC 677 the taxpayer sold the rights, which were attached to the interest coupon she owned, in exchange for an annuity contract. The court held that the proceeds of sale of the rights attached to the coupon constituted disposal of a capital asset. It is immaterial what it was exchanged for. In this case Lord Rooker held:

“...The only question to be decided is whether the proceeds of sale of a right to receive income in future can be treated as income for the purpose

of the Income Tax Acts. The question thus broadly stated plainly admits of but one answer, and that answer must be in the negative. The proceeds of the sale for a lump sum of an annuity, for instance, are capital in the hands of the vendor and not income...”

In *Glenboig Union Fireclay Co Ltd v Commissioners of Inland Revenue* 12 TC 427 the company was bound by the statutory power of the railway company to refrain, once and for all, its right to dig certain fireclay in return for a payment. This was held to have sterilized a portion of its capital, thus this is said to constitute capital receipts. In this case, the exploitation of fireclay is a capital asset of the company. Thus, any compensation received for such compulsory purchase of capital assets would be a capital receipt. A similar decision was also reached in *Commissioners of Inland Revenue v Glasgow and South Western Railway Co* (1887) AC 315.

Circulating capitals are disposal made in the ordinary course of business, in which transaction ownership passes with intention of making a profit. Such assets are commonly referred to as trading stocks. Disposal or destruction of such asset will be treated as revenue. Such proceeds need not necessarily come from customers. It also includes compensation from insurance companies and the government for compulsory acquisition. Such receipt is said to have been received in the ordinary course of business.

In *Commissioners of Inland Revenue v Newcastle Breweries Ltd* 12 TC 927, the House of Lords held that a sum awarded by the War Compensation Court to the brewery in respect of the compulsory acquisition of its stock of rum by the admiralty was a trading receipt. The court was of the opinion that both the sum paid and the

rum is within the realm of circulating capital. In *John Smith and Son v Moore* 12 TC 266, it was held that the disposal of circulating capital constitutes revenue receipts. Although the taxpayer argued forcefully that such receipt was paid for the interference of its trade and was not received in the ordinary course of the trade Rowlatt J. at first instance rejected such argument and held that it was in substance a sale of the company's trading stock and thus the fact that it was under compulsion was irrelevant.

Similarly, a sum recovered from the insurance company for the destruction by fire of their stocks was also held to be trading receipts as seen in the case of *Green v Gliksten and Son Ltd* 14 TC 364.

It is therefore concluded that once an asset has been deemed trading stocks, the sale of such trading stock would amount to trading receipts and any compensation received from the rights attached to the trading stock is equally tantamount to income receipts. An asset that has been classified as trading stock gives a trader various rights. He will have the right to the price once it has been sold to the trade debtors or alternatively, a right to damages against its purchaser. In the event that insurance policies have been taken, there is an automatic right to compensation from the insurance company if the trading stock is accidentally lost or destroyed. In the event that the goods are compulsory acquired by the government, a right to compensation by the government can also arise. A right against the tortfeasor can also arise if it is negligently damaged or destroyed. All these rights are rights arising out of trading stocks and any compensation received will be treated as revenue receipts. This

proposition of law was also affirmed in the House of Lords by Lord Hoffmann in *Deeny and Ors v Gooda Walker Ltd and Ors* 67 TC 458.

3.3 Conclusion

From the situations explained in chapter 2 hereof and as discussed above and volume of cases decided by courts on the issue of income alone loudly screams that there exist ambiguity as to what constitute income. Ambiguity here refers to meaning of the many type of income which is stated briefly in section 4 Income Tax Act 1967. When is it considered as capital in which event it is not taxable and when is it considered as revenue in which event, it is taxable. This causes uncertainty on part of taxpayer as nobody could be certain as to the clear definition. There of course there are light shed in the form of judicial interpretations but again how many people has excess to the legal journals and even if they do how many could understand the legal language . Legal consultation comes with cost namely in the form of payment of fees to lawyers or any relevant person giving legal opinion. From observation of our Income Tax Act 1967 itself the sections that are clearly defined do not go to courts often as opposed to cases on section 4. One such section for comparison would be section 25 which provides for basis period to which gross income from an employment is related:-

(1) Subject to subsection (1A), where gross income from an employment:

(a) is not receivable in respect of any particular period; and

(b) first becomes receivable in the relevant period, it shall when received be treated as gross income of the relevant person for the relevant period.

(1A) The gross income from an employment in respect of any right to acquire shares in a company of the kind to which paragraph 13(1)(a) applies, shall where the right is exercised, assigned, released or acquired in the relevant period be treated as gross income of the relevant person for that relevant period.

(2) Subject to section 3 and subsection (5), where gross income from an employment is receivable in respect of the whole of the relevant period (or, except in a case to which subsection (4) applies, in respect of any part of the relevant period), it shall when received be treated as gross income of the relevant person for the relevant period.

(3) Subject to section 3 and subsection (5), where gross income falls to be treated under subsection (1) or (2) as gross income for the relevant period, then, if its receipt first becomes known to the Director General on a day more than five years after the end of the relevant period, it shall whenever necessary be treated as gross income of the relevant person for the basis period for the year of assessment which began five years before the beginning of the year of assessment which includes that day.

(4) Subject to section 3 and subsection (5), where gross income from an employment is receivable in respect of a period (in this subsection referred to as the overlapping period) which overlaps the relevant period, that gross income when received shall be apportioned between the part of the overlapping period which overlaps the relevant period and the remaining part of the overlapping period (the apportionment, unless the Director General having regard to the facts of any particular case otherwise directs, being made in the proportion that the number of days of the overlapping period that fall into the relevant period bears to the total number of days of the overlapping period) and so much of that gross income as is apportioned to the overlapping part of the overlapping period shall be treated as gross income of the relevant person from the employment for the relevant period:

Provided that:

(a) where the employment ceases in the basis period for a year of assessment and, at or about the time of the cessation of the employment, gross income from the employment becomes receivable as a lump sum by way of gratuity, deferred pay or otherwise but excluding any amount which by virtue of paragraph 13(1)(d) or (e) is included in his gross income from the Employment, then, for the purposes of this subsection:

(i) that sum, notwithstanding subsection (1), shall be treated as accruing evenly over and receivable in respect of an accrual period consisting of the period of the employment (including, where the employment was employment by a company, any particular period during which the

relevant person was employed by another company in the same group, being a group of which that first mentioned company was a member at the time of the cessation of the employment) or, if the period of employment (including any such particular period) commenced more than five years before the commencement of that basis period, an accrual period consisting of that basis period and the basis periods for the five years of assessment immediately preceding that year;

(ii) so much of that sum as by virtue of subparagraph (i) is treated as accruing evenly over and receivable in respect of any such particular period during which the relevant person was employed by any such other company shall be deemed to be income from the source consisting of his employment by that other company and not from the source consisting of the employment by that first mentioned company; and

(iii) that accrual period shall be treated as the overlapping period;

(b) where the overlapping period in respect of which that gross income is receivable partly elapsed more than five years before the day on which the receipt of that gross income first became known to the Director General, then, for the purposes of this subsection, that gross income shall whenever necessary be deemed to have been receivable in respect of and to have accrued evenly over that part of the overlapping period which did not so elapse and, if that part falls wholly into the relevant period, shall whenever necessary be deemed to be gross income of the relevant person from the employment for the relevant period;

(c) where the overlapping period in respect of which that gross income is receivable wholly elapsed more than five years before the day on which the receipt of that gross income first became known to the Director General, that gross income shall whenever necessary be treated as gross income for the basis period for the year of assessment which began five years before the beginning of the year of assessment which includes that day.

(5) Where gross income from an employment first becomes receivable in the relevant period and is in respect of:

(a) a period which commences after the end of the relevant period; or

(b) a period which overlaps the relevant period and which partly elapsed after the end of the relevant period, subsections (2) to (4) shall not apply and that gross income shall when received be treated as gross income of the relevant person for the relevant period:

Provided that, where the relevant period wholly elapsed more than five years before the day on which the receipt of that gross income first became known to the Director General, that gross income shall whenever necessary be treated as gross income of the relevant person for the basis

period for the year of assessment which began five years before the beginning of the year of assessment which includes that day.

(6) Notwithstanding the foregoing subsections, where the Director General is satisfied that:

(a) an employee has left or will be leaving Malaysia in the basis year for the year of assessment to which the relevant period relates (that year of assessment being in this subsection referred to as the relevant year) and will not be resident for the basis year for the following year of assessment;

(b) no pension derived from Malaysia will be receivable by the employee for the basis period for that following year; and

(c) gross income from the employee's employment will cease to be derived from Malaysia on the expiration of a period of leave following the employee's departure from Malaysia, any gross income from the employment which but for this subsection would by virtue of any of the foregoing subsections be receivable for the basis period for the year of assessment following the relevant year shall be treated as receivable for the relevant period unless the employee in making his return of income for the relevant year (or within such period after the making of that return as the Director General may allow) makes a written request to the Director General that this subsection shall not apply in relation to his gross income from the employment.

Trial as all of us know generally are time consuming as it involves reading and preparing the brief, getting up, research, drafting pleadings, serving pleadings, trials in court which requires calling witnesses and oral testimony on oath and decisions which may go to appeals. When this happens not only the litigants have to incur expenses but it is also time consuming which can be said as wasting valuable time not only for the litigants but also valuable judicial time of the court.

CHAPTER 4

COMPARISON WITH OTHER JURISDICTIONS

4.1 Introduction

In this chapter the main discussion will revolve around comparison as to how statutes governing income tax and the provisions thereof have been drafted and the details provided in other jurisdictions namely India and United Kingdom. To facilitate that purpose it is very important to reproduce the whole of the relevant sections related to what constitutes income as only then can the comparison be effectively made. In fact the reproduction of the provision would be what is famously quoted in Latin as “*res ipsa loquitur*” which means “it speaks for itself”. By reproducing the sections in entirety and to compare it with our section 4 would suffice to show the glaring difference even without any explanation, discussion or comments. For the purpose of comparison in so far as this research is concerned, the discussion will specifically be towards the provisions relating to heads or limbs of income or the definition thereof, particularly towards gains tax, business and corporate tax, interest, dividend, shares, rent and gifts to name a few which is specifically mentioned or defined in the statute itself.

For purposes of introduction to the systems employed in those jurisdictions, some general information are shared to facilitate better understanding and to operate as an overview. Large portions of the statutes needs to be reproduced here as the main

purpose of this paper is to dwell on the inadequacy of section 4 Income Tax Act 1967 in defining income.

4.1 Position in India

The information provided here are mainly from the official website of Indian Income Tax Department and Income Tax Act 1961 itself which is self sufficient with all the explanations, examples and provisos provided in the form of footnotes in the statute. In India the Central Government is empowered by Entry 82 of the Union List of Schedule VII of the Indian Constitution to levy tax on all income except for income derived from agriculture subject to section 10(1) of Income Tax Rules 1962. Income Tax Law comprises of Income Tax Act 1961, Income Tax Rules 1962, Notifications and Circulars issued by the Central Board Of Direct Taxes (CBDT), Annual Finance Acts and Judicial pronouncements by Supreme Court and High Courts.

In India tax is imposed on taxable income of all which includes individuals, firms, companies, local authority, association of persons and Hindu Undivided Families. The chargeability is based on nature of income, namely as to whether it is revenue or capital. In Indian Income Tax Act, the issue of what is income is well defined in the statute itself and detail explanation is given such as, in what circumstance dividend is taxable. The same goes to salary, gift and rent. For example, income of an individual is segregated into five heads and classified as heads of income. They are income from salaries, income from house property, profits and gains of business or profession, capital gains and income from other sources. Before proceeding further in

explaining what each of this limb stands for it is prudent to look at the actual wording of the statute which is self explanatory.

4.2.1 Section 14 Income Tax Act 1961

Section 14 of Income Tax Act 1961 which provides for heads of income reads as:-

” Save as otherwise provided by this Act, all income shall, for the purposes of charge of income-tax and computation of total income, be classified under the following heads of income:—

- A. *Salaries;*
- B. *Deleted;*
- C. *Income from house property;*
- D. *Profits and gains of business or profession;*
- E. *Capital gains;*
- F. *Income from other sources.*

4.2.1.1 Income from salary

Income from salaries clearly defined in section 15 Income Tax Act 1961 of the act namely all income received as salary under employer-employee relationship is taxed under this head, on due or receipt basis, whichever arises earlier. Employers must withhold tax compulsorily (subject to Section 192), if income exceeds minimum exemption limit, as Tax Deducted at Sources (TDS), and provide their employees with a Form 16 which shows the tax deductions and net paid income. The Act contains non exhaustive exemptions too.

4.2.1.2 Income from house property

Any income under this head is taxable if the assesses are the owner of a property consisting of building or land appurtenant thereto and is not used by him for his business or professional purpose. An individual or Hindu Undivided Family or better known as HUF is eligible to claim any one property as self-occupied if it is used for own or family's residential purpose. Such a benefit can only be claimed for one house property. However, the individual or HUF will still be entitled to claim Interest on borrowed capital as deduction under section 24 of the act, subject to some conditions.

In the case of a self occupied house deduction on account of interest on borrowed capital is subject to a maximum limit of Rs150000 if loan is taken on or after 1 April 1999 and construction is completed within 3 years and Rs30000 if the loan is taken before 1 April 1999. For let-out property, all interest is deductible, with no upper limits. The balance is added to taxable income.

4.2.1.3 Profits and gains of business or profession

Income from profits and gains of business or profession provided for in section 28 Income Tax Act 1961. The incomes chargeable as income from business or profession shall be computed in accordance with the provisions contained in sections 30 to 43D of the 1961 act. However, there are few more sections under sections 44 to 44DA of the 1961 act except for sections 44AA, 44AB & 44C, which contain the computation completely within itself. Section 44C of 1961 act is a disallowance

provision in the case non-residents. Section 44AA of the 1961 act provides for maintenance of books. Section 44AB of the same act provides for audit of accounts.

4.2.1.4 Income from capital gains

Any dealing or transfer of capital assets results in capital gains. Capital asset is defined under section 2(14) of Income Tax Act 1961 as property of any kind held by an assessee such as real estate, equity shares, bonds, jewellery, paintings, art etc. but does not include some items like any stock-in-trade for businesses and personal effects. For purposes of easy reference and understanding the whole section 2(14) is reproduced here for purposes of easy comparison with section 4 of Income Tax Act 1967 governing Malaysian position:-

Section 2(14):-

“...capital asset” means property of any kind held by an assessee, whether or not connected with his business or profession, but does not include;

(i) Any stock-in-trade, consumable stores or raw materials held for the purposes of his business or profession;

(ii) personal effects, that is to say, movable property (including wearing apparel and furniture) held for personal use by the assessee or any member of his family dependent on him, but excludes ;

(a) Jewellery;

(b) Archaeological collections;

(c) Drawings;

(d) Paintings;

(e) Sculptures; or

(f) Any work of art.

Explanation:- For the purposes of this sub-clause, "jewellery" includes:-

(a) ornaments made of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals, whether or not containing any precious or semi-precious stone, and whether or not worked or sewn into any wearing apparel;

(b) precious or semi-precious stones, whether or not set in any furniture, utensil or other article or worked or sewn into any wearing apparel ;

(iii) agricultural land in India, not being land situate:-

(a) in any area which is comprised within the jurisdiction of a municipality (whether known as a municipality, municipal corporation, notified area committee, town area committee, town committee, or by any other name) or a cantonment board and which has a population of not less than ten thousand according to the last preceding census of which the relevant figures have been published before the first day of the previous year; or

(b) in any area within such distance, not being more than eight kilometres, from the local limits of any municipality or cantonment board referred to in item (a), as the Central Government may, having regard to the extent of, and scope for, urbanisation of that area and other relevant considerations, specify in this behalf by notification in the Official Gazette;

(iv) 6½ per cent Gold Bonds, 1977, or 7 per cent Gold Bonds, 1980, or National Defence Gold Bonds, 1980, issued by the Central Government ;

(v) Special Bearer Bonds, 1991, issued by the Central Government;

(vi) Gold Deposit Bonds issued under the Gold Deposit Scheme, 1999 notified by the Central Government;

Transfer has been defined under section 2(47) of 1961 act includes sale, exchange, relinquishment of asset extinguishment of rights in an asset .Cost of acquisition & cost of improvement shall be indexed in case the capital asset is long term. For tax purposes, there are two types of capital assets: Long term and short term. Transfer of long term assets gives rise to long term capital gains. The benefit of indexation is

available only for long term capital assets. If the period of holding is more than 36 months, the capital asset is long term, otherwise it is short term. However, in the below mentioned cases, the capital asset held for more than 12 months will be treated as long term namely any share in any company, Government securities, Listed debentures, Units of UTI or mutual fund, and Zero Coupon bond. Also, in certain cases, indexation benefit may not be available even though the capital asset is long term. Such cases include depreciable asset as stated in Section 50 of the 1961 act, Slump Sale as stated in Section 50B of the same act, bonds or debentures other than capital indexed bonds and certain other express provisions in the 1961 act.

The statute also clearly defines and draws clear lines for taxation of long term capital gains namely:

1. As stipulated in section 10(38) of Income Tax Act 1961 long term capital gains on shares or securities or mutual funds on which Securities Transaction Tax (hereinafter referred to STT) has been deducted and paid, no tax is payable. STT has been applied on all stock market transactions since October 2004 but does not apply to off-market transactions and company buybacks. Therefore, the higher capital gains taxes will apply to such transactions where STT is not paid.
2. In case of other shares and securities, person has an option to either index costs to inflation and pay 20% of indexed gains, or pay 10% of non - indexed gains. The cost inflation index rates are released by the Income Tax department each year.

3. In case of all other long term capital gains, indexation benefit is available and tax rate is 20%.

4.2.1.5 Income from other sources

Income from other sources is provided for in section 56 of Income Tax Act 1961. This is a residual head. Under this head income which does not meet criteria to go to other heads is taxed. There are also some specific incomes which are to be always taxed under this head:-

1. Income by way of dividends;
2. Income from horse races/lotteries;
3. Employees' contribution towards staff welfare scheme;
4. Interest on securities (debentures, Government securities and bonds);
5. Any amount received from keyman insurance policy as donation;
6. Gifts (subject to certain conditions and exemptions);
7. Interest on compensation/enhanced compensation;
8. Income from renting of other than house property;
9. Family pension received by family members after the death of the pensioner;
10. Income by way of interest on other than securities;

11. Gifts received by the assesses

Under the Income Tax Act 1961, particularly section 56(2)(vii) any gifts received shall be taxed as income from other sources . The section reads as:-

(1) Income of every kind which is not to be excluded from the total income under this Act shall be chargeable to income-tax under the head "Income from other sources", if it is not chargeable to income-tax under any of the heads specified in section 14, items A to E.

(2) In particular, and without prejudice to the generality of the provisions of subsection (1), the following incomes, shall be chargeable to income-tax under the head "Income from other sources", namely:-

(i) dividends;

(ia) income referred to in sub-clause (viii) of clause (24) of section 2;

(ib) income referred to in sub-clause (ix) of clause (24) of section 2;

(ic) income referred to in sub-clause (x) of clause (24) of section 2, if such income is not chargeable to income-tax under the head "Profits and gains of business or profession";

(id) income by way of interest on securities, if the income is not chargeable to income-tax under the head "Profits and gains of business or profession" ;

(ii) income from machinery, plant or furniture belonging to the assesses and let on hire, if the income is not chargeable to income-tax under the head "Profits and gains of business or profession";

(iii) where an assesses lets on hire machinery, plant or furniture belonging to him and also buildings, and the letting of the buildings is inseparable from the letting of the said machinery, plant or furniture, the income from such letting, if it is not chargeable to income-tax under the head "Profits and gains of business or profession";

(iv) income referred to in sub-clause (xi) of clause (24) of section 2, if such income is not chargeable to income-tax under the head "Profits and gains of business or profession" or under the head "Salaries";

(v) where any sum of money exceeding twenty-five thousand rupees is received without consideration by an individual or a Hindu undivided family from any person on or after the 1st day of September, 2004 but before the 1st day of April, 2006], the whole of such sum :

Provided that this clause shall not apply to any sum of money received—

(a) from any relative; or

(b) on the occasion of the marriage of the individual; or

(c) under a will or by way of inheritance; or

(d) in contemplation of death of the payer; or

(e) from any local authority as defined in the Explanation to clause (20) of section 10; or

(f) from any fund or foundation or university or other educational institution or hospital or other medical institution or any trust or institution referred to in clause (23C) of section 10; or

(g) from any trust or institution registered under section 12AA.

Explanation:- for the purposes of this clause, “relative” means:-

(i) spouse of the individual;

(ii) brother or sister of the individual;

(iii) brother or sister of the spouse of the individual;

(iv) brother or sister of either of the parents of the individual;

(v) any lineal ascendant or descendant of the individual;

(vi) any lineal ascendant or descendant of the spouse of the individual;

(vii) spouse of the person referred to in clauses (ii) to (vi);

(vi) where any sum of money, the aggregate value of which exceeds fifty thousand rupees, is received without consideration, by an individual or a Hindu undivided family, in any previous year from any person or persons on or after the 1st day of April, 2006, the whole of the aggregate value of such sum:

Provided that this clause shall not apply to any sum of money received:-

(a) from any relative; or

(b) on the occasion of the marriage of the individual; or

(c) under a will or by way of inheritance; or

(d) in contemplation of death of the payer; or

(e) from any local authority as defined in the Explanation to clause (20) of section 10; or

(f) from any fund or foundation or university or other educational institution or hospital or other medical institution or any trust or institution referred to in clause (23C) of section 10; or

(g) from any trust or institution registered under section 12AA.

Explanation:- For the purposes of this clause, “relative” means :-

(i) spouse of the individual;

(ii) brother or sister of the individual;

(iii) brother or sister of the spouse of the individual;

(iv) brother or sister of either of the parents of the individual;

(v) any lineal ascendant or descendant of the individual;

(vi) any lineal ascendant or descendant of the spouse of the individual;

(vii) spouse of the person referred to in clauses (ii) to (vi).

Based on the above statutes from the Indian income tax act it is clearly visible the well explained differences of what can be considered as income and the circumstances in which it could actually be taxed.

This is not so in section 4 for Malaysian Income Tax Act 1967 and the definition for gift could only be obtained from case laws as stated in the case of *Yii Chee Ming v Teo Ah Khing & Anor* (2007) 4 CLJ 79 . In this case the courts defined use of the word gifts to an act of giving unsupported by valuable consideration.

4.2.2 Compulsory Acquisition

Another difference that is clearly visible would be in relation to compulsory acquisition of lands. In Malaysia this limb is not provided for expressly in our Income Tax act 1967 and it is the judiciary that has helped to shed light namely in the cases *Ketua Pengarah Hasil Dalam Negeri v Penang Realty Sdn. Bhd & Others Appeal* (2006) 2 CLJ 835, the court held that compulsory acquisition by government could be considered as the taxpayer trading in the land whereas in the case of *Lower Perak Co-operative Housing Society Bhd. v Ketua Pengarah Hasil Dalam Negeri* [1994] 2 MLJ 713 where Edgar Joseph Jr. SCJ endorsed the taxpayer's contention that "a forced sale cannot constitute a sale the proceeds of which are subject to tax because the element of compulsion vitiates the intention to trade."

In India, Income Tax Act 1961 has clearly provided for this position in section 54D which reads:-

"...Capital gain on compulsory acquisition of lands and buildings not to be charged in certain cases:-

(1) Subject to the provisions of sub-section (2), where the capital gain arises from the transfer by way of compulsory acquisition under any law of a capital asset, being land or building or any right in land or building, forming part of an industrial undertaking, belonging to the assessee which, in the two years immediately preceding the date on which the transfer took place, was being used by the assessee for the purposes of the business of the said undertaking (hereafter in this section referred to as the original asset), and the assessee has within a period of three years after that date purchased any other land or building or any right in any other land or building or constructed any other building for the purposes of shifting or re-establishing the said undertaking or setting up another industrial undertaking, then, instead of the capital gain being charged to income-tax as the income of the previous year in which the transfer took place, it shall be dealt with in accordance with the following provisions of this section, that is to say:-

(i) if the amount of the capital gain is greater than the cost of the land, building or right so purchased or the building so constructed (such land, building or right being hereafter in this section referred to as the new asset), the difference between the amount of the capital gain and the cost of the new asset shall be charged under section 45 as the income of the previous year; and for the purpose of computing in respect of the new asset any capital gain arising from its transfer within a period of three years of its purchase or construction, as the case may be, the cost shall be nil; or

(ii) if the amount of the capital gain is equal to or less than the cost of the new asset, the capital gain shall not be charged under section 45; and for the purpose of computing in respect of the new asset any capital gain arising from its transfer within a period of three years of its purchase or construction, as the case may be, the cost shall be reduced by the amount of the capital gain.

(2) The amount of the capital gain which is not utilised by the assessee for the purchase or construction of the new asset before the date of furnishing the return of income under section 139, shall be deposited by him before furnishing such return such deposit being made in any case not later than the due date applicable in the case of the assessee for furnishing the return of income under sub-section (1) of section 139 in an account in any such bank or institution as may be specified in, and utilised in accordance with, any scheme¹⁴ which the Central Government may, by notification in the Official Gazette, frame in this behalf and such return shall be accompanied by proof of such deposit; and, for the purposes of sub-section (1), the amount, if any, already utilised by the assessee for the purchase or construction of the new asset together with the amount so deposited shall be deemed to be the cost of the new asset:

Provided that if the amount deposited under this sub-section is not utilised wholly or partly for the purchase or construction of the new asset within the period specified in sub-section (1), then :-

- (ii) the amount not so utilised shall be charged under section 45 as the income of the previous year in which the period of three years from the date of the transfer of the original asset expires; and*
- (ii) the assessee shall be entitled to withdraw such amount in accordance with the scheme aforesaid.*

4.3 Position in United Kingdom

As stated above, all the information stated here has been obtained from the statute itself. Generally, taxation in United Kingdom may involve payments to a minimum of two different levels of government namely the central government and the local government. Central government revenues come primarily from income tax, National Insurance contribution, and value added tax, corporation tax and fuel duty. Local government revenues come primarily from grants from central government funds, council tax etc. In United Kingdom income tax was levied under five schedules. Income not falling within those schedules was not taxed. The schedules were:

- i) Schedule A (tax on income from United Kingdom land);
- ii) Schedule B (tax on commercial occupation of land);
- iii) Schedule C (tax on income from public securities);
- iv) Schedule D (tax on trading income, income from professions and vocations, interest, overseas income and casual income);
- v) Schedule E (tax on employment income);

Later a sixth Schedule, Schedule F (tax on United Kingdom dividend income) was added.

Most companies were taken out of the income tax net in 1965 when corporation tax was introduced. These changes were consolidated by the Income and Corporation Taxes Act 1970.

Rental income on a property investment business such as a buy to let property is taxed as other savings income, after allowing deductions including mortgage interest. The mortgage does not need to be secured against the property receiving the rent, subject to a maximum of the purchase prices of the property investment business properties or the market value at the time they transferred into the business. Joint owners can decide how they divide income and expenses, as long as one does not make a profit and the other a loss. Losses can be brought forward to subsequent years. In United Kingdom, while all income is taxable, gains are exempt for income tax purposes. Interest is paid tax-free, while dividends are paid along with a tax credit to the investor which can then be offset against dividend tax due. For a basic rate tax payer this means they have no tax to pay on a dividend.

For the purposes of comparison and discussion certain particular limbs of income namely dividend and rent will be perused here to see the detailed wordings in the statute.

4.3.1 Dividends

Dividends received by an individual from a United Kingdom resident company are charged to income tax by the Income Tax (Trading and Other Income) Act 2005. This Act states that tax is charged on the amount of dividends actually received in the tax year, with no adjustment for any accrued dividends. United Kingdom dividends have an attached tax credit which is equal to one ninth of the amount of the dividend received and an individual's dividend income for a tax year is equal to the United

Kingdom dividends received in that year plus the attached tax credit. No expenses are allowed against dividend income.

To facilitate this it is crucial to reproduce the whole of the section. In United Kingdom provision for dividend is provided under Chapter 3 of Income Tax (Trading and Other Income) Act 2005 in section 382 which reads as follows:-

“(1)(a) imposes a charge to income tax on dividends and other distributions of United Kingdom resident companies)...”;

(b) treats dividends as paid in some circumstances...”; and

(c) makes special provision where the charge is in respect of shares awarded under an approved share incentive plan (see sections 392 to 396).

(2) “...also makes provision about tax credits, tax being treated as paid and reliefs available in respect of certain distributions which applies whether or not the distributions are otherwise dealt with under this...”.

(3) For exemptions from the charge under this Chapter...”:-

-Chapter 3 of Part 6 (income from individual investment plans),

-Chapter 5 of that Part (venture capital trust dividends),

-section 770 (amounts applied by SIP trustees acquiring dividend shares or retained for reinvestment), and

-section 498 of ITEPA 2003 no charge on shares ceasing to be subject to SIP in certain circumstances.

(4) In this "dividends" does not include income treated as arising under section 410 stock dividends.

4.3.1.1.1 Charge to tax on dividends and other distributions

Section 383 of Income Tax Act (Trading and Other Income) Act 2005 which provides for tax for dividends reads as follows:-

(1) Income tax is charged on dividends and other distributions of a UK resident company.

(2) For income tax purposes such dividends and other distributions are to be treated as income.

(3) For the purposes of subsection (2), it does not matter that those dividends and other distributions are capital apart from that subsection.

4.3.1.2 Income charged

In United Kingdom, income charges provided for under section 384 of (Trading and Other Income) Act 2005 which reads as:-

(1) Tax is charged under this... on the amount or value of the dividends paid and other distributions made in the tax year.

(2) Subsection (1) is subject to:-

-section 393(2) and (3) (later charge where cash dividends retained in SIPs are paid over), and

-section 394(3)(distribution when dividend shares cease to be subject to SIP).

(3) "...also section 398 under which the amount or value of the dividends or other distributions is treated as increased if any person is entitled to a tax credit in respect of the"

4.3.1.3 Person liable to pay

In United Kingdom, there is also special mention of the person liable to pay tax for income by way of dividend which is provided under section 382 (Trading and Other Income) Act 2005 which reads as:-

(1) the person liable for any tax charged ..."

(a) the person to whom the distribution is made or is treated as made...”or

(b) the person receiving or entitled to the distribution.

(2) Subsection (1) is subject to:-

-section 393(4) (later charge where cash dividends retained in SIPs are paid over), and

-section 394(4)(distribution when dividend shares cease to be subject to SIP).

4.3.1.4 Details of amounts treated as dividends

Section 386 of (Trading and Other Income) Act 2005 provides for details of amount that is treated as dividends namely open ended investment company dividend distribution. The section reads as:-

(1) This section applies if the distribution accounts of an open-ended investment company show the total amount available for distribution to owners of shares in the company as available for distribution as dividends.

(2) Subsection (1) is subject to subsection (5).

(3) For income tax purposes dividends are treated as paid to the owners of the shares by the company.

(4) The amount of the dividends treated as paid to each owner is so much of the total amount mentioned in subsection (1) as is proportionate to the owner’s shares.

(5) This section does not apply if the open-ended investment company is an approved personal pension scheme.

(6) “...section 388 for the interpretation of this section and section 387”.

4.3.1.5 Date when dividends paid under section 386 of (Trading and Other Income) Act 2005

Section 387 of (Trading and Other Income) Act 2005 provides for determination of date on which dividends are treated as paid under section 386 of the same act.

Section 387 reads as:-

(1) This section applies for determining the date on which dividends are treated as paid under section 386.

(2) The date on which the dividends are treated as paid depends on whether a date is specified for the distribution period in question by or in accordance with—

(a) the company's instrument of incorporation and its prospectus in issue for the time being (including any supplements), or

(b) in the case of an open-ended investment company which is part of an umbrella company, such parts of those documents of the umbrella company as apply to the open-ended investment company.

(3) If such a date is so specified, the dividends are treated as paid on that date.

(4) If no such date is so specified, the dividends are treated as paid on the last day of that period.

4.3.1.6 Interpretation of sections 386 and 387 of (Trading and Other Income) Act 2005

Interpretation for the above mentioned section that is section 386 and 387 of (Trading and Other Income) Act 2005 provided in section 388 of the same act which reads as:-

(1) In sections 386 and 387 and in this section—

"approved personal pension scheme" has the same meaning as in Chapter 4 of Part 14 of ICTA ...,

"distribution" includes investment on behalf of an owner of shares in respect of the owner's accumulation shares,

"distribution accounts" means the accounts showing how the total amount available for distribution to owners of shares is calculated,

distribution period" means the period by reference to which that amount is ascertained,

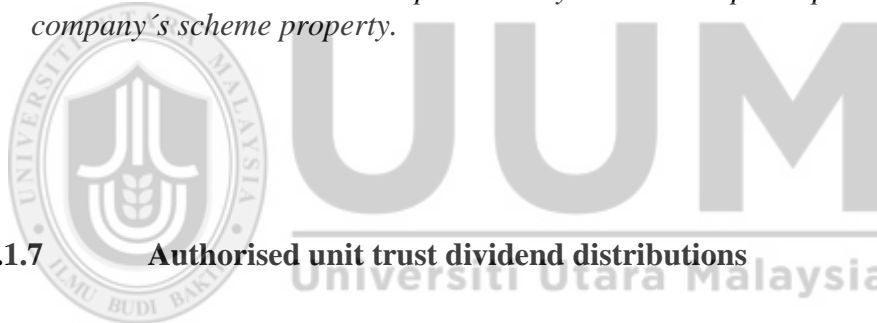
"the OEIC Regulations" means the Open-ended Investment Companies (Tax) Regulations 1997 (S.I. 1997/1154),

"open-ended investment company" has the same meaning as in Chapter 3 of Part 12 of ICTA (unit trust schemes etc...

"owner of shares" has the same meaning as in that Chapter..., and

"umbrella company" has the same meaning as in section 468 of that act...

(2) In subsection (1) "accumulation share" means a share in respect of which income is credited periodically to the capital part of the company's scheme property.



4.3.1.7 Authorised unit trust dividend distributions

Section 389 of (Trading and Other Income) Act 2005 provides for authorised unit trust dividend distribution reads as:-

(1) This section applies if the distribution accounts of an authorised unit trust show the total amount available for distribution to unit holders as available for distribution as dividends.

(2) Subsection (1) is subject to subsection (6).

(3) For income tax purposes dividends are treated as paid to the unit holders.

(4) The amount of the dividends treated as paid to each unit holder is so much of the total amount mentioned in subsection (1) as is proportionate to the unit holders' rights.

(5) The dividends are treated as paid on the shares and by the company referred to in section 468(1) of ICTA (which relates to the trustees of an authorised unit trust being treated as a UK resident company in which the unit holders' rights are shares).

(6) This section does not apply if the authorised unit trust is an approved personal pension scheme.

(7) "...section 391 for the interpretation of this section and section 390..."

4.3.1.8 Determining date when dividends paid for under section 389

As for the date on which dividends are paid under section 389 of (Trading and Other Income) Act 2005 is provided for in section 390 of the same Act which reads as:-

(1) This section applies for determining the date on which dividends are treated as paid under section 389.

(2) The date on which the dividends are treated as paid depends on whether a date is specified by or in accordance with the trust's terms for any distribution for the distribution period in question.

(3) If such a date is so specified, the dividends are treated as paid on that date.

(4) If no such date is so specified, the dividends are treated as paid on the last day of that period.

4.3.2 Rental

Apart from dividends, the other area of law that is well provided for in the United Kingdom income tax statute namely Income Tax (Trading and Other Income) Act

2005 would be provisions for rental. The provisions are spread into few separate sections with detailed provisions given for each position.

4.3.2.1 Charge to tax on rent receivable

In United Kingdom, charge for tax receivable is provided under section 355 of (Trading and Other Income) Act 2005 which reads as:-

“...Income tax is charged on rent receivable in connection with a UK section 12(4) concern...”

4.3.2.2 Meaning of rent receivable

The meaning for rent is further provided in section 336 of (Trading and Other Income) Act 2005 which reads as:-

(1) “...rent is receivable in connection with a United Kingdom section 12(4) concern if:-

(a) it is receivable in respect of an estate, interest or right in or over land in the United Kingdom, and

(b) the estate, interest or right is used, occupied or enjoyed in connection with a concern listed in section 12(4)

(2) “...rent is also receivable in connection with a UK section 12(4) concern if...”:-

(a) it is receivable in respect of an estate, interest or right in or over land in the United Kingdom;

(b) the lease or other agreement under which it is receivable provides for its recoupment by reducing royalties or payments of a similar nature, and Income Tax (Trading and Other Income) Act 2005 ;

(c) the reduction applies if the estate, interest or right is used, occupied or enjoyed in connection with a concern listed in section 12(4).

(3) In this “rent” includes :-

- (a) a receipt mentioned in section 266(3); and
- (b) any other receipt in the nature of rent.

4.3.2.3 Rental income on which tax charged

Section 337 of (Trading and Other Income) Act 2005 provides for rental income which can be taxed and it reads as:-

(1) Tax is charged under this Chapter on the full amount of the profits arising in the tax year.

(2) This is subject to section 339 (deduction for management expenses of owner of mineral rights), and section 340 (relief in respect of mineral royalties).

4.3.2.4 Person liable to pay tax for rental income

Section 338 (Trading and Other Income) Act 2005 provides for the person liable to pay tax in so far as rental income is concerned and it reads as:-

“...The person liable for any tax charged under this Chapter is the person receiving or entitled to the rent...”

4.3.2.5 Meaning of generating income from land

Section 266 (Trading and Other Income) Act 2005 explains the meaning for generating income from land which reads as:-

(1) In this... “generating income from land” means exploiting an estate, interest or right in or over land as a source of rents or other receipts.

(2) “Rents” includes payments by a tenant for work to maintain or repair leased premises which the lease does not require the tenant to carry out.

(3) “Other receipts” includes:-

(a) payments in respect of a licence to occupy or otherwise use land,

(b) payments in respect of the exercise of any other right over land, and

(c) rent charges and other annual payments reserved in respect of, or charged on or issuing out of, land.

(4) For the purposes of this section a right to use a caravan or houseboat at only one location is treated as a right deriving from an estate or interest in land.

Section 267 of (Trading and Other Income) Act 2005 provides for activities which are not considered as generating income from land and it reads as:-

For the purposes of this Chapter the following activities are not carried on for generating income from land:-

(a) “...farming or market gardening in the United Kingdom...”;

(b) any other occupation of land...; and

(c) activities for the purposes of a concern to which section 12 applies (profits of mines, quarries etc.).

4.4 Conclusion

Reading the exact wordings of the statute clearly indicates the details incorporated into the income tax act which is self explanatory and self sufficient without the need of much interpretation by the judiciary. One comparative glance at all provisions reproduced here clearly speaks, so to say the details enshrined in the provisions in

India and United Kingdom. This is not the case in our Income Tax Act 1967. Obviously the drafters had their own reasons for drafting the act in such a way but probably after looking at the time lapse from the time the act was drafted and cross referring to the volume of cases reaching the courts purely for the purposes substituting the definition of income probably some measures needs to be taken. In fact certain sections in our very own income tax act 1967 which has extensively details, which is self explanatory , we see less cases being decided in courts on that issue. This in itself is evident enough as a comparison. Section 25, 26 and 32 are some of the provisions with details as mentioned above. Further discussion as to the nature of measures to be taken would be discussed in chapter 5 as that serves as a better forum.



CHAPTER 5

CONCLUSION AND RECOMMENDATION

5.1 Introduction

In the previous chapters extensive discussion were made as to what is income for purpose of tax, what is the important ingredient in determining taxable income, the provisions provided in section 4 Income Tax Act 1967 and it's inadequacies. We have also seen the problems created by the inadequacies of section 4 in defining income and the comparison with other jurisdiction to assert the point. Taking for example the provision for rent, as to whether the sum received as rent, would it be categorized as taxable income or vice versa.

Reading the wordings of the relevant sections and provisions of income tax act in each jurisdiction or countries, it is clearly visible even without any explanation the inadequacies of section 4 Income Tax Act 1967. In Malaysia the meaning has to be substituted by judicial interpretations.

Though judiciary does provide assistance in defining income, it is nonetheless never exhaustive. The merits of each case must be considered on its own ambit. The sources do not necessarily be expected to generate continuous, but it has to be one whose objects or main intention production which returns are well defined and that does not include anything in the nature of mere windfall. Gambling or profits arising from speculative activities are considered as capital gains and are not subject to

income tax or rather not considered as income for purposes of tax. On the same accord, cost saving too not considered as income for purposes of tax.

From the discussion in chapter 3 hereof and as mentioned above it is obvious that there is eminent problem in section 4 Income Tax Act 1967 in defining income and thus creating lacuna. The volume of cases decided in courts are evidence enough to prove the amount of judicial time and revenues wasted when it could be utilised for better and more deserving purposes. That being the case and in order to avoid unnecessary wastage of valuable time and revenues in legal disputes it is prudent to look into ways to solve the problem namely in the form of some constructive amendments.

5.2 Recommendations

The amendments could be done in many ways such as amending Income Tax Act 1967 as to the section 4 or probably it could be amendment to add provisos, example or illustration. This could be seen in both United Kingdom and in Indian Income Tax Act. For reference in this chapter Indian Income Tax Act 1961 is used as it is quiet rich with detailed explanations in the form of explanations and proviso added to each relevant section. Though this section was referred in previous chapter, it is quoted again in this chapter and reproduced a portion of it to show the depth and intensity and to facilitate easy reference. Section 14 Of Income Tax Act 1961 stated in details on heads of income and further goes on to elaborate in detail what each limb stands

for and it is further enhanced by explanations. In this way the statute will be able to give a more comprehensive guide to the taxpayers or litigants looking for an answer.

The said amendments probably can take example or codify the way the statute drafted in India and United Kingdom as suggested below.

5.2.1 Categories of income

In so far as income is concerned the recommended amendment which incorporates the provisions from Income Tax Act 1961 would roughly be like suggested below.

a) Income

Except as otherwise provided in this Act, income shall, for the purposes of charge of income tax and computation of total income, be classified under the following categories of income:-

- a) Salaries;
- b) interest on securities;
- c) Income from house property;
- d) Profits and gains of business or profession;
- e) Capital gains;
- f) Income from other sources.

Expenses incurred in relation to income which is not included in total income:-

- (1) For the purposes of computing the total income under this, no deduction shall be allowed in respect of expenditure incurred by the tax payer in relation to income which does not form part of the total income under this Act.
- (2) The Officer shall determine the amount of expenditure incurred in relation to such income which does not form part of the total income under this Act in accordance with such method as may be prescribed, if the Officer, having regard to the accounts of the tax payer, is not satisfied with the correctness of the claim of the assesses in respect of such expenditure in relation to income which does not form part of the total income under this Act.
- (3) The provisions of sub-section (2) shall also apply in relation to a case where a tax payer claims that no expenditure has been incurred by him in relation to income which does not form part of the total income under this Act:

b) Salaries

The following income shall be chargeable to income-tax under the head “Salaries”:

- (a) any salary due from an employer or a former employer to the tax payer in the previous year, whether paid or not;
- (b) any salary paid or allowed to him in the previous year by or on behalf of an employer or a former employer though not due or before it became due to him;

- (c) any arrears of salary paid or allowed to him in the previous year by or on behalf of an employer or a former employer, if not charged to income-tax for any earlier previous year.

Explanation 1:- For the removal of doubts, it is hereby declared that where any salary paid in advance is included in the total income of any person for any previous year it shall not be included again in the total income of the person when the salary becomes due.

Explanation 2:- Any salary, bonus, commission or remuneration, by whatever name called, due to, or received by, a partner of a firm from the firm shall not be regarded as “salary” for the purposes of this section.

c) Deductions from salary

The income chargeable under the head salaries shall be computed after making the following deductions, namely:-

- (i) deduction in respect of any allowance in the nature of an entertainment allowance specifically granted by an employer to the tax payer who is in receipt of a salary from the government.

- (ii) a deduction of any sum paid by the tax payer on account of a tax on employment.

Salary, perquisite and profits in lieu of salary defined.

For the purposes of this section:-

(1) salary includes:-

- (i) wages;
- (ii) any annuity or pension;
- (iii) any gratuity;
- (iv) any fees, commissions, perquisites or profits in lieu of or in addition to any salary or wages;
- (v) any advance of salary;
- (vi) any payment received by an employee in respect of any period of leave not availed of by him;
- (vii) the annual accretion to the balance at the credit of an employee participating in employer provident fund;

(2) perquisite includes:-

- (i) the value of rent-free accommodation provided to the employee by his employer;
- (ii) the value of any concession in the matter of rent respecting any accommodation provided to the employee by his employer;

Explanation 1:- For the purposes of this sub-clause, concession in the matter of rent shall be deemed to have been provided if:-

(i) the accommodation is owned by the employer, the value of the accommodation determined at the specified rate in respect of the period during which the said accommodation was occupied by the employee during the previous year exceeds the rent recoverable from or payable by the employee;

(ii) the accommodation is taken on lease or rent by the employer, the value of the accommodation being the actual amount of lease rental paid or payable by the employer or fifteen per cent of salary, whichever is lower, in respect of the period during which the said accommodation was occupied by the employee during the previous year exceeds the rent recoverable from or payable by the employee;

(a) in a case where a furnished accommodation is provided by an employer:-

(i) the accommodation is owned by the employer, the value of the accommodation determined under sub-clause (i) of clause (a) as increased by the value of the furniture and fixtures in respect of the period during which the said accommodation was occupied by the employee during the previous year, exceeds the rent recoverable from, or payable by the employee;

(ii) the accommodation is taken on lease or rent by the employer, the value of the accommodation determined under sub-clause (ii) of clause (a) as increased by the value of the furniture and fixtures in respect of the period during which the said

accommodation was occupied by the employee during the previous year, exceeds the rent recoverable from or payable by the employee;

(d) in a case where the accommodation is provided by the employer in a hotel except where the employee is provided such accommodation for a period not exceeding in aggregate fifteen days on his transfer from one place to another), the value of the accommodation payable for the previous year or the actual charges paid or payable to such hotel, whichever is lower, for the period during which such accommodation is provided, exceeds the rent recoverable from, or payable by, the employee;

Explanation 2:-

For the purposes of this sub-clause, value of furniture and fixture shall be ten per cent per annum of the cost of furniture including television sets, radio sets, refrigerators, other household appliances, air-conditioning plant or equipment or other similar appliances or gadgets or if such furniture is hired from a third party, the actual hire charges payable for the same as reduced by any charges paid or payable for the same by the employee during the previous year.

Explanation 3:-

For the purposes of this sub-clause, “salary” includes the pay, allowances, bonus or commission payable monthly or otherwise or any monetary payment, by whatever name called, from one or more employers, as the case may be, but does not include the following, namely:-

- (a) dearness allowance or dearness pay unless it enters into the computation of superannuation or retirement benefits of the employee concerned;
- (b) employer's contribution to the provident fund account of the employee;
- (c) allowances which are exempted from the payment of tax;
- (d) value of the perquisites specified in this clause;
- (e) any payment or expenditure specifically excluded under the proviso to this clause.

Amendments can also be made by incorporating or codifying into the statute the many guidelines given by courts. The judicial decisions and judgements are quite rich with explanations and guidelines that are really helpful. The courts have laid down various guidelines or tests to distinguish gains arising from the disposal of an investment and gains arising from a business or trade or an adventure or concern in the nature of trade namely:

- (1) Subject matter of the transaction;
- (2) Period of ownership;
- (3) Frequency of transaction;
- (4) Alteration of property to render it more saleable;
- (5) Methods employed in disposing of property;
- (6) Circumstances responsible for sale;

5.3 Conclusions

It is quiet crucial to have a well elaborate provisions as a guide. In fact some of the section that is well defined in Income Tax Act 1967 stands prove to this as not many cases goes to court under this section. Some of the sections that is well provided in details would be section 32 Income Tax 1967 that is special provisions applicable to gross income from an employments. The other section would be section 26 of Income Tax Act 1967 that is the basic period to which gross income in respect of dividend is related. The same goes for sections 55 to 59 Income Tax Act 1967 that is related to partnerships generally, section 56 of the same act for successive partnerships, section 57 Income Tax Act 1967 related to provisions applicable where partnership is a partner in another partnership section 58 of the same act that is income receivable by partnership otherwise than from partnership business and section 59 for partnership losses. The same goes to section 60 of the same act related to insurance business and section 65 involving settlements. A well provided provisions will certainly benefit the society as a whole and tax payers in general be it individual, companies, associations or any other related party.

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