

LHAG update

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Valuation Fee Is A Deductible Expense For Tax Purposes

CP Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri (HC)

On 8.1.2019, the High Court held that valuation fee is a deductible expense under Section 33(1) of the Income Tax Act 1967 (ITA).

The taxpayer is in the business of property development, property investment and leasing of properties. In 2012, the taxpayer had incurred valuation fees to ascertain the market value of its assets. The valuation was made for the purpose of preparing the taxpayer's financial statement in accordance with the Financial Reporting Standard 140 (**FRS 140**). FRS 140 encourages an entity to determine the fair value of its investment property by an independent and professional valuer.

The Special Commissioners of Income Tax (**SCIT**) had previously ruled that the valuation fee is not deductible because it was not a mandatory expenditure in the taxpayer's ordinary course of business and the expenditure did not lead to the production or increase in profits.

The High Court subsequently allowed the taxpayer's appeal.

Necessity Not An Ingredient For Deduction

The High Court agreed with our submission that the SCIT had misdirected themselves in law by imposing an additional requirement that the valuation fee must be a mandatory expenditure in order to qualify for deduction. As elucidated in *Kok Fai Yin*'s case, one should not read into Section 33(1) of the ITA the word "necessarily" because it was not inserted by Parliament.

It was held in *Kulim Rubber*'s case that as long as an expense was made *bona fide* in the course of business, and in the interest of the efficiency of the business, and even in order to indirectly facilitate the carrying on of the business, such expense would be incurred wholly and exclusively for the production of income. This is despite the expense being made voluntarily and not out of necessity. In this regard, the valuation fee in this case was incurred to obtain the market value of the assets to substantiate the taxpayer's compliance with the

arm's length principle especially if a tax audit is conducted on the taxpayer by the Inland Revenue Board.

Production Of Actual Profit Is Not Required

Following the *Ryoshindoh Manufacturing* case, the High Court also agreed that the SCIT had erred in reading the phrase "in the production of gross income" to mean that the valuation fee had to result in an actual production or increase of profit before it is deductible. If an expense was incurred in the operation of the taxpayer's business as a whole, the expense should be deductible and the question of whether the expenditure produces or increases profits is not within the contemplation of this section.

Conclusion

Looking at the taxpayer's business, which deals with property investment and rental as a whole, the determination of market value of the taxpayer's assets was for the purpose of preparing a true and fair account of the taxpayer's business. Since the taxpayer derives its main income from property rental, the information gathered would be significant in ensuring that it transacts for the best price. For income tax purposes, it is necessary to look at a business as a whole set of operation directed towards producing income and to look at each expense in isolation would do grave injustice to the taxpayer.

Our Tax, SST & Customs partner S Saravana Kumar and associate, Steward Lee, successfully represented the taxpayer in this appeal.

If you have any questions pertaining to the deductibility of expenses, please contact <u>S Saravana Kumar</u> at <u>tax@lh-ag.com</u>

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