

Provision or Accrued expenses?
An analysis of the Court of Appeal's decision in
Exxon Chemical (M) Sdn Bhd v Ketua Pengarah Hasil
Dalam Negeri

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Introduction

The deduction of revenue expenses must satisfy the prerequisite test of s 33 of the Income Tax Act 1967 (the Act) being “wholly and exclusively”; “incurred”; and “in the production of income”. It is a well settled principle that “accrued expense” is tax deductible being an amount incurred while “provision of an expense” is not tax deductible. However, the demarcation of these two scopes is a legal point, often disputed between the tax authorities and the taxpayer. On November 24, 2005, the Court of Appeal delivered the celebrated judgment of *Exxon Chemical (M) Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri*¹ shedding light on these two issues as well as laying down the rule of interpretation of a tax Act.

The facts

The taxpayer set up a retirement and resignation benefit scheme for its employees who have worked for at least 11 years. Such qualified employees have an accrued and vested right to receive the lump sum payment when they retire, resign or when terminated from service other than for cause. At the end of each financial year, if such qualified employee demanded the retirement benefit upon leaving employment, the taxpayer is under a legal obligation to pay.

The taxpayer makes accruals each year and the amount accrued has been charged as an expense in its profit and loss accounts. The retirement amount which has been set aside is not credited to an external provident fund but instead administered entirely by the taxpayer. The issue in this case was whether such annual sum set aside is an accrual expense or a mere provision of an expense.

The tax authorities are of the view that there exists uncertainty in the realisation of the payments to its employees, the amounts set aside annually are mere estimates, contingent sums which are mere “provisions” and therefore not allowed as a tax deduction. The Special Commissioners of income tax and the

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1 [2005] 6 AMR 773.

High Court agreed with the tax authorities. Being dissatisfied with the said decision, the taxpayer appealed to the Court of Appeal.

The leading judgment of Gopal Sri Ram JCA

The crux of the dispute is whether the monies set aside each year for this retirement plan is “incurred” (accrued expense) or “not incurred” (a mere contingency or provision of an expense) in the year concerned. Gopal Sri Ram JCA delivering the landmark decision, applied the ratio decidendi of Lord Brightman in the Hong Kong Privy Council decisions of *CIR v Lo & Lo*² that “an expense incurred” is not confined to a disbursement, and must at least include a sum which there is an obligation to pay, that is to say an accrued liability which is undischarged. In short, the scope of “incurred” comprises of “paid, payable or becoming payable” so long as it includes a sum which the taxpayer is under an obligation to pay. Once an expense is established to be an accrued liability, it will be admissible in the year as an “expense incurred” and therefore tax deductible.

In this case, the Court of Appeal acknowledged that despite the fact that there exists some form of uncertainty that the amount due to the employee may be forfeited for misconduct, it would however not negate the expense from being “incurred”. If the qualified employee demanded the payment at the end of the year, the taxpayer cannot resist the claim. An expense to be incurred is not confined narrowly to mean only disbursement in that year. Gopal Sri Ram JCA held:³

... the fact that the appellant's employees did not actually receive the money in a given year does not matter. For, had any of those who were eligible to receive the benefit claimed it, then it would have been impossible for the appellant to have lawfully resisted the claim. The fact that the employees thought it fit not to make a claim but to defer it does not make the obligation to pay an expense that is incurred by the appellant non-existent.

The Court of Appeal reversed the High Court's decision and held that the sum was incurred in the respective years and thus tax deductible.

The rule of interpretation of a taxing statute

The Court of Appeal had the opportunity to reiterate the legal principles on interpretation of a taxing statute. Gopal Sri Ram JCA succinctly laid down the following propositions:

- (1) The maxim in revenue law is: no clear provision, no tax.
- (2) If there is any doubt then it must be resolved in the taxpayer's favour.

2 [1984] 1 WLR 986.

3 [2005] 6 AMR 773 at p 779.

- (3) Those parts in a revenue statute that favour the taxpayer must be read liberally.
- (4) A provision in a taxing statute must be read strictly against revenue and not in its favour.

It is interesting to note that the tax authorities urged the Court of Appeal to strictly interpret the meaning of “incurred”, applying the strict interpretation principle as propounded by Rowlatt J in *Cape Brandy Syndicate v CIR*.⁴

... One has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used.

This was however not accepted by the Court of Appeal. The learned judge held:⁵

Learned counsel for revenue submitted ... that s 33(1), being a taxing statute, should be given a strict construction and hence the words “expenses wholly and exclusively incurred” should receive a narrow interpretation. The oft quoted judgment of Rowlatt J in *Cape Brandy Syndicate v Inland Revenue Commissioners* [1921] 1 KB 64 was prayed in aid of this submission. With respect, I am unable to agree with these arguments.

... the principles that a provision in a taxing statute must be read strictly is one that is to be applied *against* revenue and not in its favour. This maxim in revenue law is this: no clear provision; no tax. If there is any doubt then it must be resolved in the taxpayer’s favour. See, *National Land Finance Co-operation Society Ltd v Director General of Inland Revenue* [1993] 2 AMR 3581; [1979-1996] AMTC 1565. The corollary of that proposition is that those parts in a revenue statute that favour the taxpayer must be read liberally. What learned counsel for revenue is asking us to do is to go the other way. That would be standing the true principle on its head.

The reliance on overseas tax precedents

Malaysia being a developing country does not have many local precedents relating to tax to guide the legal profession, judiciary, taxpayer and tax authorities. It is thus important to seek guidance from foreign tax precedents to borrow the wisdom of renowned judges to ensure justice is done. Foreign cases especially decisions of the Privy Council, House of Lords and the Supreme Court must be given great weight. Gopal Sri Ram referred to the judgment of Chang

4 [1912] 1 KB 64 at p 71.

5 [2005] 6 AMR 773 at p 778.

Min Tat FJ in *Director General of Inland Revenue v Kulim Rubber Plantations Ltd* [1979-1996] AMTC 1052.⁶

The court has laid down in *Khalid Panjang & Ors v PP (No 2)* [1964] MLJ 108 the principle that a *Privy Council decision on appeal from another country is binding on it and the other courts of this country if the appeal is on a provision of law in pari materia with a provision of the local law*. The decision in *Lasala v Lasala* [1979] 2 All ER 1146, that the Privy Council would consider itself bound by a decision of the House of Lords must extend this principle to judgments of the House of Lords. Insofar as the decisions of other courts in these and other countries are concerned, we have always treated these judgments as of only persuasive authority, but we have never lightly treated them or refused to follow them, unless we can successfully distinguish them or hold them as *per incuriam*. Other than for these reasons, we should as a matter of judicial comity and for the orderly development of law, pay due and proper attention to them. (emphasis added)

In conclusion, these decisions are highly persuasive and will serve as a guide to all interested parties on tax matters.

Conclusion

The decision of *Exxon Chemical (M) Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri* is a welcome one. It helps to reduce the cost of doing business and increase the competitiveness of a company in the global market. It is hoped that taxpayers seeking justice must not be deterred even if they are defeated at both the special commissioners and the High Court level. One must keep pursuing the door of the Court of Appeal to seek the final verdict which may result in an important victory rather than merely accepting total defeat.

⁶ Ibid at p 779.