

Listed Investment Holding Company: One Business or Three Businesses?

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Introduction

The Finance Act 2005¹ introduced a new provision i.e. s 60FA into the Income Tax Act 1967 (“the Act”) on the tax treatment of a listed investment holding company (“IHC”) to take effect from the year of assessment (“YA”) 2006. It provides preferential treatment for a listed IHC’s sources of income to be treated as business sources. However, the issue of whether dividend income, interest income and rental income received by the listed IHC constitute a single business source or three separate business sources remains contentious among tax practitioners and tax authorities.

Significance of a business source or many business sources

“Source” is an important concept in the Act as income is computed on an individual source basis. Section 33 of the Act requires expenses that are incurred wholly and exclusively in the production of income of *that source* to be deducted from the gross income of *such source*. Apportionment of common expenses incurred by a company such as overhead expenses, utilities, directors’ fees, salaries and allowances are required if there are more than one business source.

Likewise, capital allowances (“CA”) for common assets such as motor vehicles, office equipment, plant and machinery which are used in the businesses are also required to be apportioned among those businesses. The basis of apportionment remains the gross income basis according to the recent Court of Appeal decision in *Ketua Pengarah HDN v Daya Leasing Sdn Bhd*.²

Where revenue expenses are apportioned into several business sources, a current year loss is said to exist within a business source when revenue expenses exceed the gross income of such source. Such adjusted loss is deductible against the aggregate income of that YA by virtue of s 44(2) of the Act. Any unutilised business losses can be carried forward to the next YA, to be deducted from the statutory income of any business source, which may not be the same business source.³

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1 Act 644.

2 [2003-2005] AMTC 130.

3 Section 43(2) of the Act.

However, the CA allocated to any business source is deductible against that particular business source only. Any unutilised CA must be carried forward to the next YA to be deducted from the *same* business source.⁴

The above is the general rule allowing the carrying forward of unabsorbed CA and business losses for business sources. The general rule is not available to a listed IHC even though its income may now be treated as a business source. According to s 60FA(3)(a)(ii) and s 60FA(3)(b) of the Act, any unutilised CA and business losses will be lost in that YA. In addition, it is prohibited to deduct adjusted loss of a source from the aggregate income of that YA.⁵ In short, it is a loss within that business. These restrictions on deduction of adjusted loss and the carrying forward of unabsorbed CA and losses have a severe impact on listed IHCs making the treatment of a single business or three businesses a pertinent tax dispute, affecting the quantum of income tax payable.

The law

Section 60FA(2) provides:

[W]here an investment holding company is a company resident for the basis year for a year of assessment and listed on the Bursa Malaysia in the basis period for that year of assessment, income of that investment holding company from the holding of investment in that basis period shall be treated as gross income of that investment holding company from a source or sources consisting of a business for that year of assessment.

The phrase “source or sources consisting of a business” means that dividend income, interest income and rental income together constitute a single business. Similar observations can also be seen from clause 12 of the Explanatory Statement of the Finance Bill 2005. This is akin to the tax treatment of investment dealing companies where dividend, interest and rental income are regarded as a single business.

Source and business

“Source” and “business” are two distinct concepts in the Act. A *sendirian berhad* can have more than one business. A business, however, can have one or more sources of income. For example, a life insurance business has two sources of income, namely, life fund and shareholders’ fund. Likewise, a *sendirian berhad* can have two businesses such as manufacturing of instant noodles and trading in ice cream.

In *River Estates Sdn Bhd v DGIR*,⁶ the Privy Council affirmed the acceptance of the High Court and the Federal Court of the special commissioners’ analysis that one business can have three sources of income.

4 Schedule 3, para 75 of the Act.

5 Section 60FA(3)(a) of the Act.

6 [1979-1996] AMTC 1200.

Lord Scarman reproduced the analysis on p 1202:

Much thought was given by the courts below to the question whether one business could include several sources of income. The special commissioners decided that it could ..., which they found to be one business with three sources of income ... The High Court and the Federal Court accepted this analysis.

Relying on the legal principle enunciated in *River Estates*, it is concluded that a listed IHC has only one business with three sources of income, namely, dividend, interest and rental.

The landmark case of *River Estates*

In *River Estates*, the Privy Council held that a company can have more than one business. Whether a company is carrying on one or more businesses is a question of fact to be finally decided by the special commissioners. The test to decide whether two business activities constitute a single business was propounded by the eminent tax judge Rowlatt J in *Scales v George Thompson & Co Ltd*:⁷

[W]as there any inter-connection, any interlacing, any inter-dependence, any unity at all embracing those two businesses.

If two business activities are closely connected and inter-related with one another, they are one business. In a listed IHC, the direction and management of the shares, bonds and landed properties are centralised at the directors and managers. The management of the three activities is closely connected and inseparable, within centralised control of the IHC operations. These, and the inter-changeability of senior executives and staff on the management of shares, bonds and landed properties strongly suggest that there is only one business.

Parliamentary intention

Prior to YA 2006, an IHC, whether listed or not, has to treat dividend, interest and rental as investment income. This means they are treated as three separate sources of income assessable under s 4(c) and s 4(d) of the Act, and not under s 4(a) as business income. A source under s 4(a) as business income and a source under s 4(c) and s 4(d) as investment income are entirely two different concepts. A business can have more than one source of income as affirmed in the Privy Council decision of *River Estates*. This Privy Council decision does not apply to investment income under s 4(c) and s 4(d). Investment income may only have three sources: dividend income, interest income and rental income. Further subdivision within each source of dividend, interest or rental income is not possible. Contrast this with a “business”, which can have one or more sources of

7 13 TC 83.

income. In *Ketua Pengarah HDN v Multi Purpose Holdings Bhd*,⁸ KC Vohrah J, who delivered the landmark decision, acknowledged that subdivision of source applied to business but not to investment.

His Lordship held that an IHC deriving s 4(c) and s 4(d) income will have each of dividend, interest and rental income as a separate source. Each source has to be accounted for individually. Within a source such as dividend, no further subdivision into income and non-income producing source may be allowed.

Investment income assessed under s 4(c) and s 4(d) is not eligible for CA. Only common revenue expenses incurred in generating the various sources of investment income are apportioned into these three sources. Other general expenses are subject to the fraction of permitted expenses formula of $A \times B/4C$ as provided in the then s 60F(1) of the Act.

The government acknowledged the importance of listed IHCs as contributors to the national economic growth. The profits are distributed as dividend to shareholders who will further stimulate local consumption and productivity. The restriction on deduction of expenses using the statutory formula $A \times B/4C$, non-availability of CA to a listed IHC, resulted in higher tax costs to the listed IHC.

The government thus in the 2006 budget proposal provides tax incentive to listed IHCs to spearhead the national economic growth. Section 60FA was enacted to give listed IHCs preferential treatment of their income as deriving from a business source. Full deduction of revenue expenses is allowed to reduce the cost of doing business and increase tax efficiency.

Considering Parliament's intention, dividend, interest and rental income should together constitute a single business source. Parliament never intended to treat dividend, interest and rental as three separate business sources as they have been treated under investment income which requires the apportionment of revenue expenses and CA. If dividend, interest and rental were treated as three separate business sources, more losses and unutilised CA would result in a YA. These results could not be the intention of Parliament given the fact that the new legislation already has the provisions to prohibit the carrying forward of adjusted loss and CA of a business.

Further, into the provisions of the Act, gazette and orders relating to foreign fund management companies, operational headquarters, including those in the Income Tax Leasing Regulations 1986, Parliament has inserted provisions to state that the business sources are separate and distinct. The absence of such provisions from s 60FA lends support to the view that dividend, interest, and rental together form a single business source.

8 [1997-2002] AMTC 2308.

Rule of interpretation of tax statute

The recent Federal Court's decision in *Palm Oil Research and Development Board Malaysia v Premium Vegetable Oils Sdn Bhd*⁹ held that in relation to tax statutes, Parliament's intention must be strictly interpreted. Similarly, Gopal Sri Ram JCA in the Court of Appeal's decision of *Exxon Chemical (Malaysia) Sdn Bhd v Ketua Pengarah HDN*¹⁰ held that such strict interpretation has to be construed against the Revenue and not the taxpayer.

The clear words of s 60FA using "a source or sources consisting of a business" mean that listed IHCs have a single business with three sources. Even if there is ambiguity with regard to this provision, it must be construed in favour of the taxpayer as seen in the Supreme Court judgment of Gunn Chit Tuan SCJ in *National Land Finance Co-operative v DGIR*¹¹ where his Lordship held:

There are ample authorities to show that courts have refused to adopt a construction of a taxing Act which impose liability when doubt exists. In *Re Micklewait* (1855) 11 Exch 452, it was held that a subject was not to be taxed without clear words. We realise that revenue from taxation is essential to enable the government to administer the country and that the courts should help in the collection of taxes whilst remaining fair to taxpayers. Nevertheless, we should remind ourselves of the principle of strict interpretation as stated by Rowlatt J in *Cape Brandy Syndicate v Inland Revenue Commissioners* 12 TC 358 where Rowlatt J said at p 366.

"[I]n 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 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."

Postscript

In a recent dialogue between the Inland Revenue Board and tax professional bodies on March 15, 2006, the tax authorities have given their opinion that listed IHCs should treat dividend, interest or rental as three business sources instead of a single business source. Some form of business decision is thus required in the self-assessment computation. If the company feels that listed IHCs should treat the various sources of income as a single business, the following courses of action are available:

- (a) Compute on a three-business source basis and submit an appeal letter to the tax authorities, disputing its own computation.

9 [2003-2005] AMTC 85.

10 [2003-2005] AMTC 371.

11 [1979-1996] AMTC 1565.

- (b) Compute on a single-business basis and enclose a letter to the tax authorities disclosing the basis of computation relying on the legal principle of the decision in *River Estates*.

Conclusion

Tax disputes between taxpayers and tax authorities are always on uneven bearings. Tax authorities have the strength of time, manpower, and expertise to deal with taxpayers. Taxpayers are always constrained by time and have to bear the cost of employing tax consultants to argue for the tax treatment or appeal to the special commissioners.

With the greatest respect, it is hoped that tax authorities would re-examine its position and accept the single-business position for listed IHCs. The success of the self-assessment regime requires some form of certainty and the support of the tax authorities by adopting a fair stand on national interest.