

## Bumiputra Discount Contribution: Tax Deductible or Not?

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Six months have passed since the first day of the Movement Control Order. From entering unchartered territory to adapting to the new normal, businesses and taxpayers in our country are slowly regaining momentum. The same can be said for the Inland Revenue Board (**IRB**). The uptick in tax audits of late coincides with the fact that revenue collection this year is expected to be lower than previous years. And one of the main issues being raised in recent times specifically concerning property developers is that of tax deductibility of Bumiputra Discount Contribution.

### **Bumiputra Discount Contribution: What is it?**

As state authorities have full jurisdiction over land matters, regulations for the imposition of bumiputra quotas differ for each state. Generally, property developers are required to allocate at least 30% of all property units (be it residential or commercial) to bumiputras. In the event that developers are unable to fulfil such quotas imposed by the authorities, an application could be made to sell such unsold units to non-bumiputras. However, where bumiputra units are sold to non-bumiputras with approval, the developer is required to contribute the equivalent bumiputra discount (**Bumiputra Discount Contribution**) on the property to the relevant state authority. Upon making such payment in recent years, developers will ordinarily deduct the Bumiputra Discount Contribution paid as their business expenditure under s 33 of the Income Tax Act 1967 (**ITA**).

### **Deductibility: Basket provision**

Similar to other expenses, in order to obtain a deduction under s 33(1), the following elements must be satisfied:<sup>1</sup>

- (a) outgoings and expenses;
- (b) wholly and exclusively;
- (c) incurred during that period;
- (d) in the production of income; and
- (e) not prohibited under s 39(1) of the ITA.

It is imperative to examine the purpose of the payment when determining whether it is deductible or otherwise. In this instance, property developers pay the Bumiputra Discount Contribution to release the bumiputra quotas imposed when they are unable to fulfil them in order to secure non-bumiputra buyers to purchase the remaining unsold bumiputra units. It must be emphasised that an application must be made to the state authorities to release the

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<sup>1</sup> *Margaret Luping & Ors v Ketua Pengarah Hasil Dalam Negeri* [2000] 3 CLJ 409

bumiputra quotas and the Bumiputra Discount Contribution will only be paid after approval is granted. If there was no such application for the release of bumiputra quotas, there would be no sale and generation of income. It is thus reasonable to conclude that the payment is for the sole purpose of generating income for the business.

### IRB's position

However, the IRB often took the view that the payment of Bumiputra Discount Contribution to the state authorities is not deductible under s 33 on the ground that the payment is penal in nature and therefore not incurred wholly and exclusively in the production of income.

### Foreign case laws

Nevertheless, case laws paint a different picture. Similar payments made to government authorities in foreign jurisdictions (even if incidental to the taxpayer's business) have been held to be deductible expenditure. In *British Columbia Ltd*,<sup>2</sup> the Revenue discovered that the taxpayer, a registered egg producer, produced over the quota and therefore imposed an over-quota levy. The Supreme Court of Canada held that the levy was incurred as part of the taxpayer's day-to-day operations and the decision to produce over quota was a business decision made in order to realise income. Further, the levy imposed on the taxpayer is compensatory and not punitive in nature. On that basis, such levy was held to be a deductible expenditure.

In *Day & Ross Ltd*,<sup>3</sup> the issue was whether a fine for the violation by the plaintiff (i.e. taxpayer) of the provincial highway weight restriction laws is a deductible expense. The Federal Court of Canada held that the payment of fine is a revenue expense which was incurred as an item in the operation of the taxpayer's business, and is therefore deductible. In short, foreign jurisdictions have allowed payment made to the government as deductible expenses if they are compensatory and not punitive in nature. The deduction of such payment must also not be against public policy.

### Malaysian position

This issue was recently tested by our High Court in the case of *Prima Nova*,<sup>4</sup> where it held that Bumiputra Discount Contribution is deductible under s 33(1) of the ITA, thereby reversing the decision of the Special Commissioners of Income Tax (**SCIT**).

The SCIT had earlier dismissed the taxpayer's appeal on the ground that the payment of the amounts equivalent to bumiputra discount are penalties paid for breaching the bumiputra quotas and thus not wholly and exclusively incurred in the production of income, and consequently not deductible.

However, the High Court held that the Bumiputra Discount Contribution paid to the state government is closely connected to the nature of business and for generation of income by the taxpayer. The High Court observed that the requirements under s 33(1) of the ITA were fulfilled, which entitled the taxpayer to deduct the same. The Bumiputra Discount Contribution is not penal in nature based on the fact that there is no transgression of any administrative ruling. It is in fact a condition that an application must be made for release of the bumiputra quotas and the Bumiputra Discount Contribution must be made to the state authorities after approval is obtained.

<sup>2</sup> *British Columbia Ltd v Her Majesty The Queen* [1999] 3 SCR 804

<sup>3</sup> *Day & Ross Ltd v The Queen* [1977] 1 FC 780 (TD)

<sup>4</sup> *Prima Nova Harta Development Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri* (Case Number WA-14-7-12/2019)

It must be highlighted that paragraph 3.3.2 of the circular issued by the state authority states that where a developer is given a release of bumiputra quotas, it will be imposed with a “condition” that the discount must be repaid as a contribution to the state government and does not use the term “penalty”. The usage of the term “penalty” is confined to paragraph 3.2 of the circular, which will only be applicable where a developer has breached bumiputra quotas without permission and sold bumiputra units to non-bumiputra buyers.

## Our thoughts and views

In instances where the bumiputra units are sold to non-bumiputras with approval, the Bumiputra Discount Contribution would be a deductible expenditure, provided that all the requirements under s 33(1) of the ITA are fulfilled. In instances where the bumiputra units are sold to non-bumiputras without approval, we need to firstly determine whether the Bumiputra Discount Contribution and penalty are separated or lumped into a single sum. However, the penalty, which is clearly punitive in nature for not complying with the procedural requirement of obtaining prior approval, is likely to be non-deductible. There is a basis for distinguishing these two payments as it is the penalty portion which is intended to punish the business for not complying with the state’s requirement of obtaining prior approval.

As far as the decision in *Prima Nova* goes, it is currently binding on the IRB despite the fact that an appeal has been lodged to the Court of Appeal. Therefore, any tax assessments issued on the basis that deduction of Bumiputra Discount Contribution is disallowed could be challenged in court by way of judicial review, as the IRB could be seen as acting in excess of its jurisdiction.

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