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SPM Sdn Bhd v KPHDN: High Court Clarifies Legal Effect of Public Rulings, and Reinvestment Allowance

In allowing an appeal from the Special Commissioners of Income Tax (**SCIT**), the High Court has recently held that:

a. a taxpayer is not legally obliged to comply with a Public Ruling issued by the Director General of Inland Revenue (**DGIR**) under s 138A of the Income Tax Act (**ITA**);
b. the SCIT had no jurisdiction to find a taxpayer negligent within the meaning of s 91(3) of the ITA (which deals with limitation) for not complying with the Public Ruling; and
c. for the purposes of limitation under s 91(3) of the ITA, time begins to run from the year in which reinvestment allowance (**RA**) was first claimed, and not from the year when the RA was first able to be utilised;
d. a taxpayer who has diversified into a new related product is still entitled to claim RA, despite discontinuing its original product line.

This decision is important for taxpayers at large for the following reasons:

(a) it makes clear that taxpayers are not obliged to comply with Public Rulings issued under s 138A of the ITA;

(b) it demonstrates the courts' readiness to reject attempts by the DGIR to restrict incentives provided by Parliament under the ITA.

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Background

The taxpayer purchased new machineries in YA 2009 to diversify its business from manufacturing plastics for automotive components to plastics for ink cartridges. The taxpayer claimed RA for YA 2009 on the basis that it diversified its existing business into a related product within the same plastics injected moulding industry. As the taxpayer had made losses in YA 2009, it was only able to utilise the RA in YA 2010.

At the material time, the ITA did not define what amounted to "diversifying". Relying on the restrictive definition of "diversifying" in Public Ruling No 2/2008 (**PR 2/2008**), in 2015, the DGIR disallowed the RA, and raised an additional assessment for YA 2010. The public ruling states that to qualify as "diversifying", a taxpayer must produce an additional product and continue production of the existing/old product.

Pursuant to s 91(1) of the ITA, any assessment must be raised within five years, unless, among others, it is proven that the taxpayer was negligent in filing its returns. However, the DGIR contended that the five-year period should be calculated from 2010 when the RA was first utilised, not the year when RA was first claimed. Since the assessment was raised in 2015 for YA 2010, the DGIR argued that s 91(1) did not apply.

In 2017, the SCIT decided in favour of the DGIR, and disallowed the RA. The SCIT also held that the assessment was not time-barred, as the taxpayer had been negligent by failing to abide by PR 2/2008 when claiming for RA.

High Court decision

On appeal, the High Court held that a taxpayer is not legally obliged to comply with a public ruling issued by the DGIR under s 138A. Although detailed grounds of judgment are not available, it would appear that the following submissions by the taxpayer were accepted by the court:

a. A public ruling issued under s 138A represents the DGIR's public interpretation of the ITA, which he agrees to be bound by;

b. There are no provisions in the ITA which require taxpayers to comply with a public ruling. Section 138A gives taxpayers an option that they can avail themselves of, if they so choose;

c. The specific provision that introduces RA, i.e. s 133A, overrides any other provision, which includes public rulings issued under s 138A; and

d. PR 2/2008 adversely modified or reduced the scope of RA given under s 133A and Schedule 7A by restricting the definition of "diversifying".

e. Accordingly, the SCIT has no jurisdiction to find a taxpayer negligent for non-compliance with a public ruling and therefore the IRB has no legal basis to raise time-barred assessments.

The court also found that for the purposes of limitation under s 91(1) of the ITA, time began to run from the year in which RA was first claimed, and not from the year when the RA was first able to be utilised. Accordingly, the assessment that was raised in 2015 for RA first claimed in 2009 was time-barred.

Reinvestment allowance

On RA, having rejected the definition of "diversifying" in PR 2/2008, the court adopted the ordinary dictionary meaning of "diversifying". This is largely similar to the statutory definition introduced in YA 2015, i.e. "to vary its range of products". The court accepted that a taxpayer who has diversified into a new related product is still entitled to claim RA, despite discontinuing its original product line. As the new product is related to the old one, i.e. plastic components that go through a similar manufacturing process, the taxpayer was found to have "diversified" and therefore carried on a "qualifying project" for the purposes of paragraph 8 of Schedule 7A of the ITA.

The taxpayer was successfully represented in this appeal by lawyers from the firm's Tax, Customs & Trade Practice, **Dato' Nitin Nadkarni** and **Jason Tan Jia Xin**.

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