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Section 127(3A) Of The ITA Cannot Be Misapplied By The MoF and IRB

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

A dispute arose between the Director General of Inland Revenue (DGIR) and FTM as to whether the Ministry of Finance (MoF) may invoke Section 127(3A) of the Income Tax Act 1967 (ITA) to disallow FTM's entitlement to claim increased exports allowance (IEA) under the Income Tax (Allowance for Increased Exports) Rules 1999 [PU(A) 128/1999] (the Rules).

At all material times, FTM's eligibility to claim IEA was not disputed as it had satisfied all the prescribed conditions under the Rules. However, the DGIR contended that the MoF had rightly exercised its power under Section 127(3A) of the ITA to disallow FTM from claiming IEA on the ground that FTM did not incur the raw material costs for its manufacturing activity. The Rules, however, did not impose any restriction as contended by the DGIR. As stipulated under rule 8 of the Rules, only taxpayers who enjoyed an incentive under the Promotion of Investments Act 1986 or claimed reinvestment allowance under the ITA are not eligible to claim IEA.

Notwithstanding the DGIR's decision, FTM proceeded to claim IEA for the year of assessment (YA) 2013, which was disallowed by the DGIR consequent to a tax audit. The DGIR proceeded to issue a notice of additional assessment for YA 2013 with penalty. FTM appealed against the assessment to the Special Commissioners of Income Tax (SCIT), who ruled that Section 127(3A) of ITA confers power on the MoF to exclude any person from the application of the provisions of the ITA, including the Rules. Dissatisfied and disappointed with the SCIT's decision, FTM appealed to the High Court.

Last week, the High Court allowed FTM's appeal with cost and reversed the decision of the SCIT. The High Court accepted the arguments advanced by FTM that:

- (a) Section 127(3A) of the ITA must be interpreted according to its literal meaning in the spirit and intendment of the ITA by looking fairly at the language used. There is no room for any

intendment and presumption.

- (b) Section 127(3A) of the ITA is a provision to exempt a taxpayer from tax and not to exempt him from a tax incentive that he is rightfully entitled to. This is evident from the preamble of Part IX of the ITA. Further, reading the Hansard in respect of the Rules and the Explanatory Statement to the Finance Bill 2005 which introduced Section 127(3A), the SCIT had erred and misdirected themselves by agreeing with the DGIR that the MoF is empowered under Section 127(3A) to exempt FTM from the IEA.
- (c) The interpretation endorsed by the SCIT is clearly against Parliament's intention in introducing the Rules and Section 127 (3A) as the objective of the former is to attract foreign direct investment. Meanwhile, the latter is an enabling provision which confers on the MoF the power to exempt one from tax but not to exempt one from the application of the Rules.

This is a landmark decision which discusses the scope of Section 127 (3A) of the ITA and the powers of the MoF in applying the said provision. Our Tax, SST & Customs partner, S Saravana Kumar, successfully represented FTM in this appeal. He was assisted by pupil, Desmond Liew.

If you have any queries pertaining to tax incentives or are aggrieved by any decision of the IRB or MoF, please contact [S Saravana Kumar](mailto:S.Saravana.Kumar@lh-ag.com) at tax@lh-ag.com

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