

Tax e-Alert

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Tax Deductibility Of Valuation Fee

The High Court, in the recent case of *CP Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri*, allowed a taxpayer to deduct the valuation fee incurred by them to value their properties, including their investment property in the form of a shopping mall. The taxpayer was successfully represented by our Tax, SST & Customs partner, S Saravana Kumar.

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Background Facts

The taxpayer is a property developer, property investor and a lessor of properties. It commissioned a valuation report for the preparation of its financial statement in accordance with the Financial Reporting Standard 140 (**FRS 140**). The valuation report provided the value of the taxpayer's properties at the end of a financial year end.

In 2012, the taxpayer incurred a valuation fee in the course of ascertaining the market value of its investment properties. The valuation report guided the taxpayer in ensuring its transactions would be made at the prevailing market price and that its properties were sold for the best prices. The taxpayer deducted the valuation fee incurred as a business expenditure under Section 33(1) of the Income Tax Act 1967 (**ITA**).

However, the Director General of Inland Revenue (**DGIR**) disallowed the deduction on the basis that the valuation fee was not a mandatory expenditure for the taxpayer. The DGIR raised a notice of additional assessment with penalty against the taxpayer. The taxpayer appealed to the Special Commissioners of Income Tax (**SCIT**), who agreed with the DGIR and held that the valuation fee was not a mandatory expenditure in the ordinary course of business and that the expenditure did not lead to the production or increase of profit.

Taxpayer's Case

The taxpayer's arguments were as follows:

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- The preparation of the FRS 140 is part of the taxpayer's statutory audit fees expenditure. This is specifically allowed as a deduction under **Paragraph 2 of the Income Tax (Deduction for Audit Expenditure) Rules 2006 (the Rules)** which states that "... for the purpose of ascertaining the adjusted income, there shall be allowed a deduction of an amount equivalent to the amount of statutory audit fees expenditure incurred in that basis period". The Rules were made by the Minister of Finance pursuant to Section 154(1)(b) of the ITA .
- The DGIR's Public Ruling at paragraph 5.8 of Public Ruling (PR) No 6/2006, which is titled "Tax Treatment of Legal and Profession Expenses", states that professional expenses incurred by a developer or dealer in property for valuation in land is a deductible expense. This PR specifically allows deduction for the valuation fee.

DGIR's Argument

The valuation fee incurred was not wholly and exclusively incurred in the production of income as the taxpayer was merely complying with the FRS 140. The preparation of the FRS 140 does not relate to the business. Further, the engagement of a professional valuer is not mandatory under the law.

High Court's Decision

- Necessity not an ingredient for deduction

The SCIT had misdirected themselves in law by imposing an additional requirement that an expenditure needs to be mandatory or necessary to be deductible. The High Court made reference to the *Kok Fai Yin* case, which held that one should not read the word "necessarily" into Section 33(1) as it was not inserted by Parliament. Additionally, it was held in *Kulim Rubber Plantations'* case that as long as an expense was made *bona fide* in the course of the business, in the interest of the efficiency of the business or indirectly to facilitate the carrying on of the business, such an expense is incurred wholly and exclusively for

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the production of income. This is despite the expense being incurred not out of necessity or due to a legal requirement. In this regard, the valuation fee was incurred by the taxpayer to obtain the market value of its assets for the purpose of complying with the arm's length principle.

- Production of actual profit is not required

The High Court relied on *Ryoshindoh Manufacturing* in ruling that the SCIT had erred in reading the phrase "in the production of gross income" to mean that the valuation fee had to result in an actual production or increase of profit before it is deductible. If an expense was incurred in the operation of the taxpayer's business as a whole, then the expense should be deductible. The question of whether the expenditure produces or increases profit is not relevant for the purposes of Section 33(1). The High Court arrived at the conclusion that the expense fell squarely under Section 33(1) in light of the taxpayer's principal activities. It was recognised that the valuation of the taxpayer's properties was important to the taxpayer's business.

Conclusion

Section 33(1) of the ITA governs the deductibility of a taxpayer's business expenses. If an expense is wholly and exclusively incurred in the course of business, then it would be deducted against the company's gross income. As long as the expenditure was incurred *bona fide* in the course of the company's business, in the interest of efficiency and to promote the carrying on of the company, such expense would be deemed to have been incurred wholly and exclusively for the company's production of income. The High Court in this case has made it clear that the laws are to be read as intended by Parliament, and not by the DGIR's own interpretation of the law.

If you have any queries pertaining to income tax matters, please contact our Tax, SST & Customs partners, **Datuk D P Naban** or **S Saravana Kumar**, at tax@lh-ag.com

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