

Tax e-Alert

26 APRIL 2019

Tax Avoidance Provision Cannot Be Arbitrarily Invoked

Section 140(1) of the Income Tax Act 1967 (**ITA**) empowers the Inland Revenue Board (**IRB**) to adjust or disregard any transaction that the IRB believes has a direct or indirect effect of the consequences avoiding tax. This provision grants the IRB wide powers to scrutinise a legitimate commercial transaction whereby, notwithstanding the legality of the transaction, the IRB is empowered set it aside for income tax purposes.

However, like any other provisions of the law, the IRB cannot arbitrarily invoke Section 140(1) simply for the purpose of raising additional assessment. Recently, our tax lawyers successfully represented the taxpayer in the *RF* case, in which the High Court affirmed the decision of the Special Commissioners of Income Tax (**SCIT**) that the IRB had no basis in law to invoke Section 140(1).

Brief Facts

The taxpayer is the developer of a luxury condominium project consisting of 21 units (**Project**). The Project was conceived in early 2002 by the taxpayer's eight shareholders, all of whom signed a Shareholders' Agreement in March 2002 (**Shareholders' Agreement**) which provided that, among other things, they would each buy a unit at approximately RM380 psf. However, no Sale and Purchase Agreement (**SPA**) was signed between the shareholders and the taxpayer at that time, as the taxpayer did not receive its developer's licence until 2005.

The eight SPAs for the sale of the units (**Initial Units**) were signed between 2005 and 2007. In accordance with the Shareholders' Agreement, the sale of the Initial Units was transacted at RM380 psf. Meanwhile, of the remaining 13 units, one was sold to two of those eight shareholders and the other 12 to third parties. The SPAs for the remaining 13 units were also signed between 2005 and 2007 for an average price of RM550 psf.

In 2008, the IRB conducted a tax audit on the taxpayer and invoked Section 140(1) to vary the transaction price of the Initial

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Units from RM380 to RM550 psf. According to the IRB, the variation was intended to reflect the market value of the Initial Units at the time when the SPA was signed, and this increased the taxpayer's gross income for 2007 artificially.

Taxpayer's Contentions

The taxpayer argued that the assessment raised by the IRB was invalid as the IRB had:

- failed to specify the limb in Section 140(1) under which the adjustment was made;
- failed to demonstrate that there was reason to believe that the taxpayer's business arrangement was designed to avoid tax;
- made the variation of price on mere suspicion of tax avoidance;
- no basis to invoke its power under Section 140(1) of the ITA. The difference in the prices for the Initial Units and that of the remaining 13 units was due to various commercial considerations; and
- failed to specify the particulars of adjustment together with the assessment as required under Section 140(5) of the ITA.

The IRB's Reply

The IRB's response can be summarised thus:

- The shareholders had abused their control and influence over the taxpayer to buy the Initial Units at approximately RM380 psf, which was below the market price at the time when the SPA was signed;
- The IRB and the taxpayer had held various discussions prior to the issuance of the assessment and, as such, the taxpayer was made aware that the adjustment was to counter the Initial Units' price, which the IRB considered as not being transacted at arm's length;

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- The requirement to specify the particulars of adjustment in Section 140(5) is not mandatory.

The SCIT's And High Court's Decision

The High Court affirmed the decision of the SCIT and held that the latter did not commit any error of law in arriving at the decision that the IRB had arbitrarily invoked Section 140(1).

The SCIT, after considering the evidence and submissions by both parties, unanimously allowed the taxpayer's appeal and held that the notice of additional assessment was null and void.

The SCIT's grounds can be summarised as follows:

- It is imperative for the IRB to specify the limb in Section 140(1) under which the adjustment was made. The IRB's failure to do so had deprived the taxpayer of an opportunity to fully understand and respond to the IRB's action in raising the assessment;
- There were commercial considerations to justify the sale of the Initial Units at a lower price, whereby the price of RM380 psf for the Initial Units was fixed based on a market survey conducted by the shareholders in 2002. Given that the shareholders had committed to purchase the Initial Units in 2002, it was incorrect for the IRB to measure the value of the Initial Units based on their market value in between 2005 and 2007;
- The requirement to provide the particulars of adjustment together with the assessment as prescribed under Section 140(5) is mandatory. The prior discussions between the IRB and the taxpayer could not be a basis to dispense of a statutory requirement. Hence, the IRB's failure to comply with Section 140(5) rendered the assessment null and void.

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Conclusion

This recent decision emphasises that the IRB cannot arbitrarily invoke Section 140(1) without any basis in law. The IRB must first establish that it has a reason to believe that the arrangement or transaction of the taxpayer was undertaken with the view of avoiding tax. Second, the IRB must specify which limb of Section

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140(1) that it is relying on in making the tax adjustment. This is important to enable taxpayers to understand the basis of the adjustment to enable the taxpayers to respond to the IRB. Finally, pursuant to Section 140(5), the IRB has a statutory duty to provide the particulars of adjustment with the assessment and this duty cannot be dispensed of simply because the IRB and taxpayers have had discussions in the past.

Datuk D P Naban and S Saravana Kumar from the firm's Tax, SST & Customs Practice represented the taxpayer in this case.

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