

SPECIAL ALERT  
TAX PULSE



TAX, CUSTOMS & TRADE

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## Court of Appeal Clarifies the Scope of Pioneer Status Tax Exemption Under the Promotion of Investments Act 1986

*Merimen Online Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri (KPHDN)*

“Income tax, if I may be pardoned for saying so, is a tax on income.”<sup>1</sup> This fundamental principle, laid down by the English House of Lords over a century ago and reiterated by the Malaysian courts<sup>2</sup>, underpins the taxpayer’s successful appeal and the Court of Appeal’s (“COA”) recent decision of 12.12.2024, which clarified the scope of the taxpayer’s exemption under Section 21C of the Promotion of Investments Act 1986 (“PIA”). The COA’s grounds of judgment can be viewed [here](#).

### Brief Facts

The taxpayer (“Taxpayer”) was granted MSC status in 2008 and received an MSC Status Certificate signed by the Ministers of International Trade Industry (“MITI”) and

<sup>1</sup> *London County Council v AG* [1901] AC 26

<sup>2</sup> *Lower Perak Cooperative Housing v KPHDN* [1994] 2 MLJ 713; *KPHDN v Perbadanan Kemajuan Negeri Johor* [2009] 4 MLHJ 682

Finance (“**MOF**”). This certificate entitled the Taxpayer to a 100% tax exemption should it be granted pioneer status (“**MOF Exemption**”). The Taxpayer received pioneer status and consequently took the position that 100% of its statutory income was not subject to tax.

Section 21C of the PIA governs the computation of the Taxpayer’s income during the tax exemption period. As a matter of prudence, the Taxpayer sought confirmation from the Director General of Inland Revenue (“**Revenue**”) on its interpretation of the proviso to Section 21C(2) of the PIA (“**The Disputed Proviso**”):

*(1) This section shall apply to a company which has been granted pioneer status under subsection 6(1AB).*

*(2) Subject to any condition which may be specified in the pioneer certificate of a company issued under section 7, the income of a pioneer company for each accounting period of its pioneer business shall be computed in accordance with the principal Act by:*

*(a) treating each such accounting period as the basis period for the year of assessment which includes the last day of the accounting period in question; and*

*(b) ascertaining the income in question as if it were the statutory income from the pioneer business for that year of assessment:*

***Provided that in the case of a company that is already operating in Malaysia, the income of the company for each accounting period of its pioneer business shall be the value-added income of the company.***

*(2A) For the purpose of this section-*



(a) “value-added income” means the statutory income for the basis period for the year of assessment less the inflation-adjusted base income; and

...

In particular, the Taxpayer sought confirmation that 100% of its statutory income during the exemption period was not subject to tax.

Seventeen months later, the Revenue responded, asserting that only the Taxpayer’s value-added income was exempt, while the inflation-adjusted base income remained taxable. Assessments, including for time-barred years of assessment (“YA”), were subsequently issued with penalties.

The Taxpayer’s appeals to the Special Commissioners of Income Tax (“SCIT”) and the High Court (“HC”)<sup>3</sup> were dismissed, prompting the Taxpayer to appeal to the COA.

### **Revenue’s Arguments at the COA**

The Revenue resisted the Taxpayer’s appeal, contending that:

- 1) Section 21C of the PIA is a proviso for the computation of exempted income. The effect of the Disputed Proviso is that, whilst the value-added income of the Taxpayer is exempted, the remaining statutory income, i.e., the inflation-adjusted base income, remains taxable. The MOF Exemption applies only to the Taxpayer’s value-added income.
- 2) The time-barred assessments were justified under Section 91(3) of the Income Tax Act 1967 (“ITA”) as the Taxpayer had been negligent in wrongly submitting its tax returns. The fact that the Taxpayer had engaged professional tax agents and adopted a different interpretation of Section

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<sup>3</sup> *Merimen Online Sdn Bhd v KPHDN* [2023] CLJU 1118

21C of the PIA does not release the Taxpayer of its liability under the ITA.

- 3) The penalty imposed under Section 113(2) of the ITA were appropriate, as the Taxpayer had submitted incorrect tax returns.

### **COA's Decision and the Taxpayer's Successful Contentions**

The COA accepted the Taxpayer's contentions and allowed the Taxpayer's appeal on the following grounds:

- 1) The Revenue had failed to prove negligence to justify the issuance of the time-barred assessments.

Firstly, the Taxpayer had voluntarily sought confirmation from the Revenue on its tax treatment. However, it was the Revenue that delayed its response to the Taxpayer and finally issuing the time-barred assessments after the limitation period had already lapsed.

Secondly, a taxpayer cannot automatically be said to have acted negligently by the mere act of adopting a tax treatment with which the Revenue disagrees<sup>4</sup>.

The court applied the “**reasonable man test**” to determine negligence and found that the Taxpayer had not acted negligently as he had:

- a) Engaged professional tax agents.
- b) Fully cooperated with the Revenue by providing requested documents.
- c) Filed its tax returns within the statutorily prescribed time frame.
- d) Made no attempt to evade or avoid tax.

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<sup>4</sup> Applying the principles in *Seiwa Podoyo Sdn Bhd v KPHDN* [2022] CLJU 1226 and *KPHDN v Procter & Gamble (Malaysia) Sdn Bhd* [2022] 1 LNS 754

e) Was a good corporate taxpayer that had duly paid all payable taxes on time.

2) Only the Taxpayer's "value-added income" is taxable and hence, exempted. The "inflation-adjusted base income" is not taxable in the first place.

The charge of income tax under Section 3 of the ITA only applies upon income. It is only when there is income, where income tax can be charged. And it is only when there is a liability to the charge of income tax, that the question of exemption can arise.

Here, the Disputed Proviso has provided unequivocally that only the "value-added income" of the Taxpayer is income. Contrary to the Revenue's contentions, and the SCIT's and HC's decisions, there is nothing in either the PIA or the ITA to suggest that "inflation-adjusted base income" is taxable income or that the Disputed Proviso is only for the computation of exempted income.

The legal principles in tax law are clear. The courts will read tax statutes strictly and will not read in words into a statute that do not exist<sup>5</sup>. Neither will the courts rewrite, recast, nor reframe legislation, because they do not have the power to do so<sup>6</sup>. Should there be any ambiguity, this must be construed in the Taxpayer's favour<sup>7</sup>.

3) The 100% Tax Exemption granted by MOF was unambiguous

The Taxpayer's MSC Status Certificate explicitly granted a 100% tax exemption, consistent with the MOF's powers under Section 127(3A) of the ITA.

<sup>5</sup> *National Land Finance Co-operative Society Ltd v Director General Inland Revenue* [1994] 1 MLJ 99

<sup>6</sup> *Martego Sdn Bhd v Arkitek Meor & Chew Sdn Bhd and another appeal* [2020] 6 MLJ 224

<sup>7</sup> *Exxon Chemical (Malaysia) Sdn Bhd v KPHDN* [2006] 1 MLJ 428



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The COA found no evidence that the MOF intended to exclude the inflation-adjusted base income from exemption.

In light of the above findings, the COA found no necessity to address the penalty issue further.

## Concluding Thoughts

The following lessons can be drawn from the COA's decision:

- 1) The nature of a receipt must first be identified to determine its liability to tax.
- 2) The courts will interpret tax statutes strictly and will resolve any ambiguity in favour of taxpayers.
- 3) Taxpayers cannot be said to have acted negligently simply because they adopted a different view on tax provisions than the Revenue. The "reasonable man test" applies when determining whether negligence exist.

The Taxpayer was successfully represented by **Dato' Nitin Nadkarni, Chris Toh Pei Roo**, and **Chang Jin Yee** of Lee Hishammuddin Allen & Gledhill's Tax, Customs & Trade Practice.

If you have any queries regarding tax exemptions, assessments or appeals, please contact Partner **[Chris Toh Pei Roo](mailto:tpr@lh-ag.com)** ([tpr@lh-ag.com](mailto:tpr@lh-ag.com)) or Associate **[Chang Jin Yee](mailto:cjy@lh-ag.com)** ([cjy@lh-ag.com](mailto:cjy@lh-ag.com)).