

No.12 of 1976

IN THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL

O N A P P E A L

FROM THE FEDERAL COURT OF MALAYSIA

B E T W E E N :

AMERICAN LEAF BLENDING CO. SDN BHD Appellant

- and -

DIRECTOR GENERAL OF INLAND REVENUE Respondent

CASE OF THE RESPONDENT

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- 10 1. In these proceedings the Appellant Company
appealed to the Special Commissioners against assess-
ments to income tax for the years of assessment 1968
and 1970 and the said appeal was allowed. The
Respondent thereupon appealed by way of Case Stated p.1
to the High Court of Malaya (Datuk Hashim Yeop A.
Sani J.) and his appeal was allowed in part. The
Respondent appealed to the Federal Court of Malaysia p.20
against this decision and the Appellant Company cross p.23
appealed. The Federal Court (S.S.Gill C.J., Ong Hock
20 Sim and Wan Sulemain F.J.J.) unanimously allowed the p.24
Appeal by the Respondent and dismissed the cross
appeal by the Appellant Company. The Appellant p.31
Company now appeals to His Majesty the Yang di-Pertuan
Agong having been given final leave to appeal by the
Federal Court on 10th November, 1975. p.36
2. The facts are fully set out in the Case Stated
by the Special Commissioners and may be summarised
as follows :-
- 30 (1) The Appellant Company was incorporated in 1960
with the object, inter alia, of carrying on a

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tobacco business. It commenced business in February, 1961, and was initially concerned with cutting and blending tobacco leaves and bringing them to a condition suitable for use in cigarettes.

- (2) In order to enable it to carry on the said business the Appellant Company bought some land. Thereafter it expended money in building a factory and a warehouse on it and on purchasing certain machinery. In respect of this expenditure, it was entitled to capital allowances in accordance with the provisions of the Income Tax Ordinance, 1947. 10
- (3) It found this business to be unprofitable and in November, 1961, it ceased to use the machinery it had acquired for use in the business and in 1964 it ceased to trade in tobacco. In 1967 the plant and machinery were sold and removed from the factory.
- (4) For the year of assessment 1965 the Appellant had losses totalling ₹399,303.00 which had not been able to be offset by its income for the years of assessment up to and including 1965 because of an insufficiency of income to absorb them. The said sum was, therefore, available to be deducted in subsequent years of assessment from the aggregate of its statutory income from each of its sources consisting of a business in accordance with the provisions of Section 43(1)(a) and (2) I.T.A. 1967 and the transitional provisions contained in Schedule 9 I.T.A. 1967. 20 30
- (5) For the year of assessment 1965 the Appellant had capital allowances totalling ₹82,662.00 which had not been able to be deducted from its income in respect of the years of assessment up to and including 1965. The said sum was, therefore, available to be deducted in subsequent years of assessment in accordance with the provisions of Section 42, I.T.A.1967 and the transitional provisions contained in Schedule 9, I.T.A.1967. 40
- (6) In April, 1964, the Appellant Company began to grant licences to various companies permitting them to use and occupy the premises it had built for its tobacco business (namely the factory and warehouse). In return the

companies paid the Appellant Company a rent. From 1964 to October, 1968, it only let out a part of its premises but with effect from October, 1968, it granted a licence to a company for the use and occupation of all its land and the buildings erected thereon.

- 10 (7) For the years of assessment 1968 and 1970 the Appellant Company was assessed to Income Tax in the sums of \$7,040.00 and \$33,234.00 respectively, being its income in respect of the rents referred to above.
- 20 (8) The Appellant Company claimed to be entitled to have the unabsorbed losses amounting to \$399,303.00 and the unabsorbed capital allowances amounting to \$82,662.00 set off against the rental income. This claim was disallowed by the Respondent for both the years of assessment 1968 and 1970 the Appellant appealed to the Special Commissioners.
3. The Special Commissioners held
- (a) that when in 1964 the Appellant Company commenced to grant licences over its property after it had ceased to carry on its initial tobacco business, it was carrying on a business.
- 30 (b) that, on the true construction of the relevant statutory provisions in the I.T.A. 1967, when computing its chargeable income for the years of assessment 1968 and 1970, the Appellant Company was entitled to deduct both the unabsorbed losses of \$399,303.00 and the unabsorbed capital allowances of \$82,662.00 from the income received by way of rents in respect of its premises.
4. In the High Court in Malaya the learned Judge held -
- 40 (a) that the finding of the Special Commissioners set out in Paragraph 3(a) above was finding of fact which he should not disturb
- (b) that although S.4 of the Income Tax Act,

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1967, refers separately to income in respect of

"(a) gains or profits from a business....." and

"(b) rents....."

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income in respect of rents could nonetheless be income in respect of the profits of a business.

(c) that on a true construction of the relevant statutory provisions the Appellant Company, when computing its chargeable income for the years of assessment 1968 and 1970 10

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(i) was therefore entitled to deduct the unabsorbed losses of \$399,303.00; but

(ii) was not entitled to deduct the unabsorbed capital allowances of \$82,662.00, since such allowances had not been made in relation to the source consisting of the particular business (namely the rents) from which the income from which it was desired to make the deduction was derived. 20

5. In the Federal Court

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(a) Gill C.J. (with whom Ong Hock Sim and Wan Sulemair F.J.J. agreed) held that the Special Commissioners misdirected themselves in law in holding that when the Appellant Company began to grant licences over its property it was carrying on a business 30

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(b) it therefore followed that, on the basis that the Appellant Company was not carrying on a business by owning land and making an income by letting it, the Appellant Company was not entitled to deduct either the unabsorbed losses of \$399,303.00 or the unabsorbed capital allowances of \$82,662.00 from the income it received by way of rent in respect of its premises. 40

(c) but the Court further held that, even if

the renting of the premises was assumed to be a business, the learned judge in the High Court was right, for the reasons which he gave, in holding that the Appellant Company was not entitled to deduct the unabsorbed capital allowances when computing its chargeable income for the years of assessment 1968 and 1970.

10 5. It is the view of the Respondent that, in these circumstances, this Appeal first raises the following issues

(a) whether, on a true construction of the Income Tax Act, 1967, rental income can be income in respect of gains or profits from a business.

20 (b) Did the Special Commissioners misdirect themselves in holding that in granting licences over its property the Appellant Company was carrying on a business.

7. If on either of these issues the correct view is that for the purposes of the Income Tax Act, 1967, the Appellant Company was not carrying on a business by granting licences in respect of its premises, it follows that it was not entitled to set off either its unabsorbed losses or its unabsorbed capital allowances and no further issues arise.

30 8. If, on the other hand, on both these issues the correct view is that the Appellant Company was so carrying on a business, there is a further issue, namely whether on a true construction of the relevant statutory provision the Appellant Company when computing its chargeable income for the years of assessment 1968 and 1970 was entitled to set off its unabsorbed capital allowances against the income received by way of rents. The Respondent does not
40 contend that if the Appellant Company was carrying on business by receiving rents it is not entitled to set off its unabsorbed losses of \$399,303.00 against its income from rents.

9. On the first issue (set out in paragraph 6(a) above) the Respondent will contend that rental income cannot, for the purposes of the

Income Tax Act, 1967, also be income in respect of gains or profits from a business because

- (a) on the true and natural construction of S.4 of the Act, each of its sub-paragraphs is mutually exclusive and that which is directly within the scope of a specific sub-paragraph cannot, or cannot at the election of the taxpayer, be treated as being within the scope of another less specific sub-paragraph which is less directly and plainly applicable thereto. 10
- (b) The decision and reasoning in Fry v. Salisbury House Estate Limited (1930) A.C. 432 is applicable.
- (c) In computing his chargeable income a taxpayer must obey the provisions of Section 5(a)-(d) Income Tax Act, 1967, in respect of each of his sources of income. On a true construction of the provisions of the Act the treatment of the different sources set out in Section 4 is not in all respects the same from which, in the Respondent's submission, it may be inferred that the legislature intended the different sources to be mutually exclusive. 20

10. On the second issue (set out in Paragraph 6(b) above) the Respondent will contend that the Special Commissioners misdirected themselves in law in finding that the Appellant Company was carrying on a business when it granted licences over its premises in return for rents. In support of this contention the Respondent will rely upon the reasoning of Gill C.J. in the Federal Court which in the Respondent's submission is correct. 30

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The Respondent will submit that a company may act as a landowner in the same way that an individual may, and that where, as on the facts in this case, there is no evidence that the Company was doing more than acting as a landowner turning to profitable account the land of which he is owner by receiving rents in respect of it, such an activity is not in law carrying on a business. Furthermore the fact that the Company was permitted by its articles to receive rents does not make the receiving of rents a business for the purposes of the Income Tax Act, 1967, as the Act by its terms contemplates that a company may have 40

sources of income which are not sources consisting of a business.

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10 11. On the further issue (set out in Paragraph 8 above) the Respondent will contend that even if the granting of licences in respect of the premises did constitute the carrying on of a business, the Appellant Company was not entitled to set off against such rental income the unabsorbed capital allowances made in relation to its tobacco business, since such allowances were not made in relation to the source or the business from which the rental income was derived. In support of this contention the Respondent will rely upon the reasoning of Hashim Sani J. and Gill C.J., which in the Respondent's submission is correct.

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20 12. The Respondent respectfully submits that this appeal should be dismissed with costs for the following among other

R E A S O N S

- 30 (1) BECAUSE the deciding order and the reasoning of the Federal Court, was correct.
- (2) BECAUSE on the facts stated and agreed the Appellant Company at the relevant times was not as a matter of law carrying on a business when it granted licences over its property and received rents from the licencees.
- 40 (3) BECAUSE rents cannot for the purposes of the Income Tax Act, 1967, be income in respect of gains or profits from a business.
- (4) BECAUSE on a proper construction of the provisions of the Income Tax Act, 1967, where in one years of assessment all the capital allowances to which a taxpayer is entitled in relation to a particular course of income cannot all be deducted from his adjusted income from that source they may be carried forward and deducted in the following and successive years of assessment from the adjusted income from that source but may not be deducted from the income from any other sources.

PATRICK MEDD

CHRISTOPHER BATHURST

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