

IN THE JUDICIAL COMMITTEE OF  
THE PRIVY COUNCIL

No. 28 of 1978

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O N A P P E A L  
FROM THE FEDERAL COURT OF MALAYSIA

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B E T W E E N

LAHAD DATU TIMBER  
SENDIRIAN BERHAD

Appellant

- and -

10 THE DIRECTOR GENERAL  
OF INLAND REVENUE

Respondent

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CASE FOR THE RESPONDENT

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Record

1. Section 20, Supplementary Income Tax Act, 1967, imposed a tax known as the Timber Profits Tax upon the income of any person derived from timber operations. The Timber Profits Tax is additional to any Income Tax charged in respect of a person under the Income Tax Act, 1967.

20 2. The first question raised by this Appeal is whether the Special Commissioners were wrong in law in holding, as they did, that the profits (being the balance of receipts over expenditure) accruing to the Appellant for the year ending 31st December 1968, in respect of certain transactions carried out by the Appellant were chargeable to Timber Profits Tax for the year of assessment 1969.

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3. It will be the submission of the Respondent that the answer to this question depends, in accordance with the well-known principles laid down in Edwards (Inspector of

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Taxes) v. Bairstow & Harrison [1956] A.C. 14, on whether the true and only reasonable conclusion to be drawn from the facts found by the Special Commissioners contradicted their determination, or whether the Special Commissioners misdirected themselves as to the law applicable. In the submission of the Respondent this question resolves itself on the facts into the question whether the true and only reasonable conclusion is that the profits above referred to were not "income derived from timber operations". Only if no reasonable commissioner could have found that the profits were income derived from timber operations should an appellate court reverse the decision of the Special Commissioners.

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4. "Income derived from timber operations" is defined in Section 19, Supplementary Income Tax Act, 1967, as including :

"all premiums, rents and tributes (by whatever name called) derived from timber operations, or from the granting or assignment of any rights, privileges, licences, or concessions (by whatever name called) for the extraction of timber from a forest in Malaysia".

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And "timber operations" is defined as meaning :

"the extraction of timber from a forest in Malaysia or the granting or assignment of any rights, privileges, licences or concessions (by whatever name called) for the extraction of such timber but does not include the processing, milling, sawing or manufacturing of the timber".

5. If Your Lordships were to hold that the Special Commissioners were wrong in their conclusion that the profits were income derived from timber operations, a second point is raised by the Appeal, namely, whether in those circumstances the Respondent may rely upon Section 140(1) Income Tax Act, 1967, which is an anti-tax avoidance Section. It was not necessary for the Special Commissioners to decide this point and they made no observations about it in their decision save insofar as they may have intended to refer to it when they said that they agreed with the contention advanced on behalf of the Respondent.

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6. Finally the Appeal raises a third point, namely whether the Special Commissioners were wrong in law in deciding, as they did, that three payments made by the Appellant in the course of the transactions carried out by them in the year ending 31st December 1968, were not allowable deductions in computing the Appellant's adjusted income for the year of assessment 1969. The Special Commissioners held that the payments were not expenses wholly and exclusively incurred in the production of the Appellant's gross income and so were not deductible under the provisions of Section 33(1) Income Tax Act, 1967, and also because they were sums which fell within the provisions of Section 39(1) Income Tax Act, 1967, which, so far as material, provides that :

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"39. (1) Subject to any express provision of this Act, in ascertaining the adjusted income of any person from any source for the basic period for a year of assessment no deduction from the gross income from that source for that period shall be allowed in respect of -

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(a) .....

(g) any sum, by whatever name called, payable (otherwise than to a State Government) for the use of a licence or permit to extract timber from a forest in Malaysia".

7. The Special Commissioners found in the Respondent's favour on the first and third of these points. On Appeal to the High Court in Borneo, Yusoff J. allowed the Appellant's appeal on the first point and held in its favour on the second point. He allowed the Appellant's appeal on the third point so far as it related to two of the three payments that were disputed.

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The Federal Court of Malaysia (Lee Hun Hoe C.J., Borneo, Ong F.J. and Ho J.) allowed the present Respondent's appeal.

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8. The facts relating to the appeal are set out fully in the stated case and may be summarised as follows. The Appellant Company was incorporated on 10th December 1966, with objects, inter alia, of carrying on the businesses

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of forest operators and of timber merchants and of taking over the benefit of a contract (the Timber Extraction Contract) that had earlier (on 6th September 1966) been entered into by the two original subscribers to the Appellant's Memorandum and Articles (the promoters).

9. The other party to the Timber Extraction Contract was the Alu Tungku Co-operative Land Development Society (the Society) to whom certain state land (the land) had been alienated for the purposes of agricultural development and in whose favour a timber licence had been granted by the State Government permitting the Society to extract timber from the land and thereafter to remove and sell the timber. 10

10. The Timber Extraction Contract was not produced before the Special Commissioners by the Appellant and its terms were not in evidence. In the event the Appellant did not take over the Timber Extraction Contract but, instead, entered into two separate contracts with the Society.

One of these contracts described as an "Agreement for Timber Extraction" provided, inter alia, that the Appellant should fell and cut the timber in certain specified areas of the land and remove it to a log pond. In consideration for the Appellant so doing the Society agreed to give to the Appellant full and uninterrupted access to the land and further agreed to pay the Appellant one dollar per cubic foot of timber so felled, cut and removed. 20

11. The other contract entered into between the Appellant and the Society was entered into on the same day as the Agreement for Timber Extraction and was headed "Agreement for Timber Export and Execution of certain works". 30

It provided, inter alia, that :

(1) The Society would permit the Appellant to sell and export on the Society's behalf the timber felled cut and extracted from the land and delivered to an agreed log pond;

(2) The Society would give to the Appellant full

and unrestricted access to the land to enable it to carry out its operations under the agreement;

(3) The Appellant was to be permitted to sell the timber either in the name of the Society or in its own name.

10           Though the agreement made no specific provision as to how the full amount of the price of any timber sold was to be dealt with, it is, in the submission of the Respondent, to be inferred from the terms of the agreement and from the surrounding circumstances, that the Appellant should be entitled to the price subject to its liability under various terms of the agreement (summarised below) to pay specific sums to the Society, the Government and others.

(4) The Appellant would pay any royalty due to the Government in respect of the timber felled and extracted to the log pond;

20           (5) The Appellant would pay for the timber extracted and delivered to the log pond "as may be due to any Contractor from the Society" (sic);

(6) The Appellant would construct certain specified roads and buildings on the land at costs not exceeding certain specified sums;

(7) The Appellant would over the period of the contract pay to the Society a sum of \$587,000 being the sum assessed and required to plant certain areas of the land with coconuts and cover plants, to maintain the area so planted for a period of six months and for providing 12 miles of fencing;

30           (8) Whenever timber was sold and exported the Appellant would, for each log of 6 foot girth or more, pay to the Society 21 cents per cubic foot and would, for each log of less than six foot girth, pay to the Society 5 cents per cubic foot.

12. In the year with which this appeal is concerned the Appellant did not itself carry out the felling, cutting and extraction of the timber, nor did it itself arrange the sale

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and export of the timber. The Appellant on 28th June 1967, entered into a further contract with Yong Bros. by which Yong Bros. agreed to act as sub-contractors and to fell, cut and extract the timber and to arrange for its sale and export in consideration of payment of 82 cents for each cubic foot of timber felled, cut and extracted and the payment of 2% commission of the sale price of timber sold. In pursuance of this contract during the year to 31st December 1968, Yong Bros. felled, cut and extracted and arranged for the sale and export of, a quantity of timber from the land. Yong Bros. collected the proceeds of the sales of the timber so arranged and, after deducting their extraction charges of 82 cents per cubic foot and their sales commission of 2%, paid the balance to the Appellant.

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13. In its accounts for the year to 31st December 1968, being the accounts for the period with which this appeal is concerned, the Appellant shewed that :

(i) It had received as proceeds of the sale of 686,775 cubic foot of timber \$1,789,645.59;

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(ii) It had paid out during the year the following sums in connection with the said proceeds :

Royalty	\$ 300,380.69
Commission to the Society	\$140,175.54
Extraction Fee	\$ 686,775.70
Planting payments	\$ 201,000.00
Development costs	\$158,000.00
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	\$1,486,331.93
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The difference between the proceeds received and the total of the sums paid out, namely \$303,313.66 was shewn in the profit and loss account as "Agency fee" received.

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14. The Special Commissioners found that the process

of extraction and sale of the timber was one continuous operation carried out by Yong Bros. under the terms of the contract of 28th June 1967, by which they acted as sub-contractors of the Appellant, and they concluded that the sum of \$303,313.66 represented income derived by the Appellant from timber operations within the meaning of Section 20, Supplementary Income Tax Act, 1967.

10 15. On the first question it will be the contention of the Respondent that as a result of the contractual rights and duties created between the Society (the original grantee of the licence to extract and sell the timber) and the Appellant, and the contractual rights and duties created between the Appellant and Yong Bros., Yong Bros. were enabled to exercise the rights granted by the timber licence and were enabled to extract and sell the timber. At the same time, by virtue of the contractual rights and duties created between the same parties, as Yong Bros. extracted and sold the timber  
20 the profit of \$303,313.66 enured to the Appellant.

In these circumstances the granting by the Appellant of the rights for the extraction of the timber to Yong Bros. and the extraction and selling of the timber by Yong Bros. as sub-contractor for the Appellant resulted in the income for the Appellant of \$303,313.66. Thus it is true to say that the income of \$303,313.66 in the hands of the Appellant can properly be regarded as "income derived from timber operations" because either  
30 it is income derived from "the extraction of timber from a forest in Malaysia" or it is income derived from "the granting of rights for the extraction of such timber". Thus the Respondent will submit that it cannot be said that the true and only reasonable conclusion on the facts found by the Special Commissioners contradicted their decision. Indeed it is respectfully submitted that no other conclusion would have been reasonable.

40 16. On the second question, if, contrary to the Respondent's contention, the Special Commissioners were wrong to decide the first point as they did, the Respondent will contend, in the alternative, that he is entitled to rely upon the anti-avoidance provisions of Section 140(1), Income Tax Act, 1967.

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Section 140, so far as material, is in these terms :

140 (1) The Director General where he has reason to believe that any transaction has the direct or indirect effect of -

(a) altering the incidence of tax which is payable or suffered or which would otherwise have been payable or suffered by any person;

(b) relieving any person from any liability which has arisen or which would otherwise have arisen to pay tax or make a return;

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(c) .....

(d) .....

may, without prejudice to such validity as it may have in any other respect or for any other purpose, disregard or vary the transaction and make such adjustments as he thinks fit with a view to counteracting the whole or any part of any such direct or indirect effect of the transaction.

(2) .....

(8) In this section -

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"transaction" means any trust, grant, covenant, agreement, arrangement or other disposition or transaction made or entered into orally or in writing .....

17. Though the wording of this Section is not the same as that of the similar anti-avoidance Sections in Australia (Section 260, Commonwealth of Australia Income Tax and Social Services Contribution Assessment Act, 1936-1951) it will be submitted that the approach to be adopted when considering how the Section is to be applied in a particular case is the same as the approach adopted by Your Lordships when considering the Australian legislation in Newton v. Commissioner of Taxation [1958] A.C. 450 where Lord Denning giving the decision of the Board at p. 465-466 said :

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"In applying the Section you must ... look at the arrangement itself and see which (sic) is its effect, irrespective of the motive of the person who made it."

18. It is the contention of the Respondent that, in the light of that guidance, one must look at the effect of the transactions in the present appeal and compare that effect with what it is reasonable to suppose would have happened had the original Timber Extraction Contract  
 10 between the Society and the Promoters been assigned to the Appellant as was originally intended. When that comparison is made it is submitted that the only possible conclusion is that the effect of the transactions was to "alter the incidence of tax ... which would otherwise have been payable by" the Appellant.

In these circumstances in the words of Lord Denning in Newton v. Commissioner of Taxation (supra), it can be predicated that the arrangement was imple-  
 20 mented in the particular way it was so as to avoid tax. The Appellant has not suggested any other reason, nor is there any apparent commercial reason, why the arrangement should have been implemented in this way.

19. The third question. The Special Commissioners found that three sums, viz :

Development cost	\$158,000.00
Planting payment	\$201,000.00
Commission	\$140,175.54

30 which the Appellant sought to deduct in computing its adjusted income for the year of assessment 1969, were in fact paid to the Society in consideration for the assignment of the rights and privileges under the timber licence. They, therefore, held that the sums were not deductible because they were sums "payable (otherwise than to a State Government) for the use of a licence or permit to extract timber from a forest in Malaysia" and as such came within the terms of Section 39(1)(g) Income Tax Act, 1967, which expressly forbids such deductions.

20. By the terms of the second agreement with the Society (Agreement for Timber Export and execution of certain works) the Appellant was allowed to remove the timber from the log pond and sell it. Had there been no such agreement the only person entitled to remove and sell the timber would have been the Society and it was only entitled so to do by virtue of the licence to extract timber from the land and thereafter to remove and sell it which, as the Special Commissioners found, had been granted to the Society by the State Government. Therefore, it is submitted, by allowing the Appellant to remove and sell the timber the Society was allowing the Appellant to use the licence within the meaning of Section 39(1)(g) Income Tax Act, 1967. It will be further contended by the Respondent that the permitting of the Appellant to use the licence was the only consideration moving from the Society under the contract and that, therefore, the payment by the Appellant of the various sums for which it became liable under the contract (which included the three sums above referred to) was payment for the use of a licence or permit to extract timber within the meaning of Section 39(1)(g). Thus, it is submitted, the decision of the Special Commissioners on this point was correct.

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21. The Respondent, therefore, submits that this appeal should be dismissed with costs for the following, among other

R E A S O N S

1. BECAUSE on the facts found by the Special Commissioners it cannot be said that the true and only reasonable conclusion contradicted their finding that the sum of \$303,313.66 referred to in the Appellant's accounts as "Agency Fee" was income derived from timber operations within the meaning of Section 20(1) Supplementary Income Tax Act, 1967.
2. BECAUSE the Special Commissioners did not misdirect themselves as to the law on the question whether the said sum was income from timber operations.

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- 10 3. BECAUSE, alternatively, if, contrary to the Respondent's contentions above, the said sum was not income from timber operations, the transactions which had the effect of causing the said sum to be treated as not being income from timber operations had the direct or indirect effect of altering the incidence of tax which would otherwise have been payable by the Appellant and the Respondent was entitled to counteract the effect of the transactions in accordance with the provisions of Section 140(1) Income Tax Act, 1967.
4. BECAUSE the payments respectively entitled Development Cost \$158,000.00, Planting Payment \$201,000.00, Commission \$140,175.54 were not permissible deductions in the computation of the adjusted income of the Appellant for the year of assessment 1969.
- 20 5. BECAUSE the reasons given in the Judgment of Lee Hun Ho, C.J. Borneo, and concurred in by Ong F.J. and Ho J. in the Federal Court are sound and should be upheld.

PATRICK MEDD

No. 28 of 1978

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THE PRIVY COUNCIL

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ON APPEAL  
FROM THE FEDERAL COURT OF  
MALAYSIA

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BETWEEN

LAHAD DATU TIMBER  
SENDIRIAN BERHAD

Appellant

- and -

THE DIRECTOR GENERAL  
OF INLAND REVENUE

Respondent

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CASE FOR THE RESPONDENT

---

STEPHENSON HARWOOD,  
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Gutter Lane,  
LONDON, EC2V 6BS.

SOLICITORS FOR THE RESPONDENT