

O N A P P E A L

FROM THE FEDERAL COURT OF MALAYSIA

B E T W E E N :-

CHU LIP KONG Appellant

- AND -

THE DIRECTOR GENERAL OF INLAND REVENUE Respondent

CASE FOR THE APPELLANT

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10 1. This is an appeal from the judgment of the Federal Court of Malaysia (Lee Hun Hoe, C.J., Borneo, H.S. Ong, F.J. Charles Ho, J.) dated the 19th June, 1978 dismissing an appeal by the Appellant from the judgment of the High Court in Borneo (B.T.H. Lee, J.) dated the 9th February, 1977 dismissing an appeal by the Appellant from an Order of the Special Commissioners of Income Tax dated 14th June, 1974 which dismissed the Appellant's appeal against a notice of additional assessment to income tax dated 20 11th March, 1972 in respect of the Year of Assessment 1967.

The question raised by the appeal is whether or not a profit realised by the Appellant from the disposal of property in Sabah was a profit from a trade or business carried on by the Appellant, and therefore liable to tax under Section 9(1) of the Income Tax (Sabah) Ordinance 1956.

2. The facts found by the Special Commissioners to have been admitted or proved may be summarised as follows:-

- (i) The Appellant had business interests in cattle farming, rubber and coconut estates, besides being a contractor for timber hauling, road construction and supply of rubber seedlings. p.4 l.37
- (ii) The Appellant previously developed a cattle farm of 814 acres in an area known as Gum Gum Kechil in the District of Sandakan. He had also extracted some timber and sold it. p.5 l.9

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- p.5 1.38 (iii) In 1963 the Appellant had, after an aerial survey, decided that the Kinabatangan property was suitable for cattle farming, with timber on it available for fencing, cattle sheds and paddock fencing, and with the prospect of cattle on it being safer from theft.
- p.6 1.22 (iv) On 22nd April 1964 the Appellant agreed to buy the property, which amounted to some 6,666 acres for \$320,000. The memorandum of transfer was duly registered on 7th October 1964. 10
- p.6 1.28 (v) In June 1964 the Appellant sent the first group of ten workers to the property to look for the boundary stones and also to fence the area.
- p. 1.35 A small gauge railway line of $3\frac{1}{2}$ miles was constructed running to the higher part of the property where the headquarters were to be established. A locomotive was built, together with 20 wooden trucks each capable of holding 4 or 5 workers. 20
- p.7 1.6 (vi) The Appellant visited the property 12-14 times during the $2\frac{1}{2}$ years following the purchase. On each occasion he stayed 4 or 5 days, directing and supervising the workers.
- p.7 1.10 He planned to develop the property in 5 stages working on about 1,000 acres at a time. His intention was to plant grass, put up fencing and divide the areas into paddocks.
- p.7 1.18 (vii) In the first year of his ownership, the Appellant did not notice that the property was subject to flooding. But at the end of 1964 and again at the end of 1965 he found many parts of the low lying areas flooded. (The annual rainy season lasted from October to January). 30
- p.7 1.27 In June and July 1966, the Appellant found the low lying areas still be to flooded. After all these visits he felt very frustrated and decided to sell the property which he concluded would not suitable for cattle farming.
- p.7 1.33 (viii) The Appellant obtained a timber licence from the Forestry Department in March 1966, but no timber was extracted during the currency of the licence and it was cancelled, at the Appellant's request, on 26th October 1966. 40
- p.7 1.41 (ix) On 25th October 1966 the Appellant sold the property to Chin Yin Khee for \$580,000. The purchase price was paid as to \$380,000 on the signing of the agreement. The balance of \$200,000 was to be paid on 24th April 1967.

To secure the latter payment, the purchaser gave the Appellant a cheque for \$200,000 post-dated to 24th April 1967 and drawn by Kim Hong Co. Ltd., a timber company.

- 10 (x) On the same day, 25th October 1966, Chin Yin Khee p.8 1.16 agreed to sell all the commercial timber on the property to Kim Hong Co. Ltd. for \$595,000. Of this sum, \$395,000 was paid to Chin Yin Khee on the signing of the agreement and the balance was to be paid on 24th April 1967 by means of the cheque for \$200,000 which Chin Yin Khee had given to the Appellant.
- (xi) Between 1966 and 1971 Kim Hong Co. Ltd. succeeded p.9 1.8 in extracting very substantial quantities for timber from the property.
- (xii) On 9th September 1969, Chin Yin Khee sold the p.10 1.1 property for \$8,000.

20 3. The relevant provisions of the Income Tax (Sabah) Ordinance can be summarised as follows:-

Section 9(1) provides that income tax shall subject to the provisions of this Ordinance, be payable at the rate or rates specified hereinafter for each year of assessment upon the income of any person accruing in or derived from Sabah or received in Sabah from outside Sabah in respect of -

30 (a) gains or profits from any trade, business, profession or vocation, for whatever period of time such trade, business, profession or vocation may have been carried on or exercised.....

Section 12(1) provides that for the purposes of ascertaining the income of any person for any period from any source chargeable with tax under this Ordinance, in this Part referred to as "the income", there shall be deducted from outgoings and expenses wholly and exclusively incurred during that period by such person in the production of the income.

40 Section 26(1) provides that where the Commissioner is of the opinion that any transaction which reduces or would reduce the amount of tax payable by any person is artificial or fictitious or that any disposition is not in fact given effect to, he may disregard any such transaction or disposition and the persons concerned shall be assessable accordingly.

(2) In this section "disposition" includes any trust, grant, covenant, agreement or arrangements.

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(3) Nothing contained in this section shall prevent the decision of the Commissioner in the exercise of any discretion given to him by this section from being questioned in an appeal against an assessment in accordance with Part XII.

(Section 26 is included for the sake of completeness, but does not appear to have been referred to before the Special Commissioners, and is not mentioned in the Stated Case or in the judgments of the Courts below). 10

p.10 1.6 4. At the hearing before the Special Commissioners the Appellant contended that the profit of \$176,774.00 realised by the Appellant on the sale of the land was a capital appreciation and not a profit or gain arising out of his trade or business; and that it was an isolated transaction as regards sale of land.

p.20 1.29 5. The Special Commissioners held that the sale of land by the Appellant was fictitious and that the real sale was one of timber by the Appellant to Kim Hong Co. Ltd; that the profit from the sale was not a capital appreciation but a profit from timber trading; and that a sum of \$23,703.00 made up of commission, legal fees and transfer fees in connection with the sale of the said land was not an allowable deduction under Section 12(1) of the Sabah Income Tax Ordinance, 1956. 20

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p.24 1.10 6. In the High Court of Borneo, B.P.H. Lee J. remarked at the beginning of his judgment that there was no dispute as to the facts, Having summarised the facts, the contentions of the parties and the decision of the Special Commissioners, he said that the question for determination was whether the profit was chargeable to income tax under Section 9(1)(a) of the Ordinance. The Special Commissioners had found that the Appellant was trading in timber. 30

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As regards the expenses which the Special Commissioners had disallowed, these will only be deductible if they had been incurred in the production of income. The production of income here was the production of income from the timber proceeds. If the expenses incurred were in respect of a fictitious transfer of land they were not allowable. The Appellant's trade here was not the land transaction but the timber trade. He could see no good reason why the decision of the Special Commissioners should be disturbed. 40

7. Upon the appeal of the Appellant to the Federal Court of Malaysia, the judgment of the Court was delivered by H.S. Ong FJ.

Adopting the view of the Special Commissioners and the High Court, H.S. Ong FJ. said:- 50

"The Special Commissioners disbelieved the sale of the property to Chin Yin Khee. They did so because there was an admission that the cheque of \$200,000 used by Chin Yin Khee to pay the balance of the purchase price was the one issued of Kim Hong Co. Ltd. who was the eventual purchaser of the commercial timber on the property.....

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On the evidence it was a possible conclusion that the sale to Chin Yin Khee was a colourable device and that the sale was one to a logging firm. There was ample evidence before the Special Commissioners to come to the finding that the difference in the consideration was not a capital appreciation but a profit arising from the taxpayer's trade and therefore chargeable to tax. The Learned Judge also accepted this and it will be wrong for this Court to come to any other conclusion".

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8. The difficulty about the Special Commissioners decision is that it totally contradicts their findings of fact.

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The main contradiction concerns the nature of the transaction from which the profit arose. According to the findings of fact, it was a sale of land by the Appellant to Chin Yin Khee. According to the decision, it was a fictitious sale of land, and a real sale of timber by the Appellant to Kim Hong Co. Ltd.

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The contradiction is of fundamental importance. It is well settled that, for those who trade in the produce of land (such as timber, or minerals or growing crops), the cost of the land or interest in land from which they derive their trading stock is capital expenditure: see, for example, the judgment of Your Lordships' Committee in Kauri Timber Co. Ltd. v. Commissioner of Taxes 1913 A.C. 771. By the same token, the proceeds of sale of the land or interest in land are a capital receipt, not a profit of the trade. Presumably the Special Commissioners had this in mind when they gave their decision on the basis that the sale was a sale of timber rather than of land.

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It is respectfully submitted that even on this basis the Special Commissioners' decision was misconceived. The contract between Chin Yin Khee and Kim Hong Co. Ltd. was one for the sale of growing timber rather than cut timber, and should perhaps more accurately be described as a sale of the right to cut down growing timber and take it away. As such, it should be classified as the sale of an interest in land and thus, in the case of a timber merchant, as a

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sale of a capital asset rather than of trading stock. But since, according to the Special Commissioners' findings of fact, the transaction was in any event a sale of land, the point does not in the Appellant's submission arise.

9. It is not altogether easy to see how the contradiction between findings of fact and decision arose.

p.7 1.41 The finding in paragraph 8(p) of the Stated Case that the Appellant sold the property to Chin Yin Khee on 26th October 1966 appears to represent an admitted fact, taken from a Statement of Facts agreed between the parties. For the most part, the contentions of the Respondent before the Special Commissioners were evidently to the effect that the taxable profit was the profit realised by the Appellant and upon that sale of land: see in particular paragraph 10(e) and (k) of the Case. 10

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p.14 1.31 and p.16 1.38 The Respondent does not, however, seem to have felt inhibited by the Agreed Statement from contending in the alternative that the sale agreement between the Appellant and Chin Yin Khee was a nullity: see paragraph 10(h) of the Case. The ground upon which the contention was advanced by the Respondent, namely that "there was no consideration" is in the Appellant's submission plainly erroneous, but this in the contention which the decision of the Special Commissioners seems to reflect. 20

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p.8 1.35 and p.10 1.1 The Appellant would accept that either party to an agreed statement of facts might justifiably seek to withdraw from the agreement either in advance or in the course of a hearing before Special Commissioners, and might put the other party to proof of the facts upon which reliance is placed. In such a case, it might turn out that the other party was unable to prove what had previously been agreed. The present case is not, however, a case of that sort. The Special Commissioners' ultimate findings of fact reproduce the substance of the Agreed Statement, and embellish it by identifying Chin Yin Khee as the vendor of the timber to Kim Hong Co. Ltd. and as the vendor of the land in September 1969: see paragraph 8(r) and (t). In the Appellant's submission it is quite unacceptable that a contention should be advanced and a decision given against him by reference to facts quite different from those admitted or proved. The Appellant submits that for this reason alone the decision of the Special Commissioners should be set aside. 30 40

10. The Appellant further submits that the decision, broadly to the effect that the Appellant's acquisition and dealing with the property amounted to a business of trading in timber, contradicts their findings that the purpose of the Appellant was to develop the property as a cattle farm, and that he decided to sell it when that 50

purpose was frustrated. For this reason also, the Appellant respectfully submits that the decision of the Special Commissioners cannot stand.

11. The Appellant does not know whether the Respondent will seek to contend before Your Lordships that the claim for tax is justified by reference to the provisions of Section 26 of the Ordinance.

10 The Appellant respectfully submits that the Respondent should not be allowed to invoke Section 26 at this stage. It is implicit in the terms of the Section that the taxpayer should be warned of the Commissioner's decision to invoke the Section at the time when the relevant assessment is made, or at the latest when the appeal comes before the Special Commissioners. Otherwise the taxpayer would have no warning of the case which he had to meet at the hearing. (It is understood that the Section has not been invoked in practice)

20 The Appellant further submits that, in any event, the Section is inapplicable to the facts found in the present case. The sale of the property to Chin Yin Khee was not fictitious. Nor was it artificial. There is nothing artificial about a sale of timber-bearing land. The fact that the Appellant's receipt of the purchase price was linked to the performance of the agreement on the same day between Chin Yin Khee and Kim Hong Co. Ltd. does not, it is submitted, affect the genuineness or commercial reality of the sale by the Appellant.

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12. The Appellant submits that the judgment of the Federal Court should be reversed and that this appeal should be allowed with costs here and below for the following among other

R E A S O N S

(1) BECAUSE the decision of the Special Commissioners was inconsistent with their findings of fact and should not have been upheld by the High Court and the Federal Court.

40 (2) BECAUSE the primary facts as found by the Special Commissioners cannot support the proposition that the sale by the Appellant of the property was fictitious.

(3) BECAUSE the sale of the property upon the facts found was an isolated transaction falling outside the scope of the charging provisions of the Sabah Income Tax Ordinance 1956.

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(4) BECAUSE the property was acquired and sold as a capital asset and the gain arising therefrom was therefore a capital gain.

MICHAEL NOLAN, Q.C.

S. WOODHULL

No. 21 of 1979

IN THE JUDICIAL COMMITTEE OF THE PRIVY
COUNCIL

ON APPEAL

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CHU LIP KONG Appellant

- AND -

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Respondent

CASE FOR THE APPELLANT

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