

CONSTITUTIONALITY OF SECTIONS 4C AND 24(1) (aa), INCOME TAX ACT 1967

By

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The net effect of Section 4C and Section 24(1) (aa) of the Income Tax Act 1967 (ITA) is that compensation for compulsory acquisition of land which is stock in trade of a company, is taxable.

The case of Wiramuda (M) Sdn Bhd v DGIR arose from the acquisition by Selangor State Government of land belonging to Wiramuda for the construction of the Sungai Besi-Ulu Kelang Elevated Expressway (SUKE). Wiramuda was awarded compensation of RM202,552,569.50.

Subsequently, Wiramuda received a notice of assessment from Inland Revenue Board (IRB) stating that the compensation was subject to income tax under Section 4C of the ITA. The tax assessed was in the amount of RM52,966,517.27.

Wiramuda did not appeal against the assessment to the Special Commissioners of Income Tax (SCIT) as provided by Section 99(1) of the ITA but chose to challenge the assessment by way of judicial review.

Leave having been given, after hearing full arguments, the High Court dismissed the application by Wiramuda.

Wiramuda appealed to the Court of Appeal. In its judgment, the Court of Appeal decided on three core issues:

- (i) Whether section 4C of the ITA is unconstitutional for contravention of Article 13(2) of the Federal Constitution.
- (ii) Whether the appellant in the present case can bypass the statutory (not alternative) remedy of appeal to the SCIT under section 99(1) of the ITA.
- (iii) Whether the appellant's compulsorily acquired land is stock in trade as envisaged under section 4C and 24(1) (aa) of the ITA.

The court answered question (i) in the negative ("No").

The court answered question (ii) in the negative ("No").

The court answered question (iii) in the affirmative ("Yes").

Take note that one of the grounds both the High Court and the Court of Appeal decided in favor of IRB is that Wiramuda should not bypass the statutory remedy of appeal to the SCIT under section 99(1) of the ITA (Ground (ii) of Court of Appeal's Judgment.)

Wiramuda applied for leave of the Federal Court to appeal against the judgment of the Court of Appeal giving seven questions for the court to answer in the appeal, if leave is granted:

Question 1: Whether Section 4C and Section 24(1) (aa) of the ITA which were enacted through the Finance Act 2014 are unconstitutional, null, void and of no legal effect on the ground that it contravenes Article 13(2) of the Federal Constitution?

Question 2: Whether Section 4C of the ITA is in contravention with Article 13(2) of the Federal Constitution as it deprives the Applicant of adequate compensation granted in accordance with the Land Acquisition Act 1960 ("LAA")?

Question 3: Whether Article 4(1) of the Federal Constitution is applicable in light of Section 4C of the ITA being inconsistent with Article 13(2) of the Federal Constitution?

Question 4: Whether the presumption of the constitutionality of Section 4C of the ITA is rebuttable presumption?

Question 5: Whether the Applicant's land (which was compulsorily acquired under the LAA was held as stock in trade or as fixed asset is an irrelevant fact to determine the constitutionality of Section 4C and Section 24(1) (aa) of the ITA?

Question 6: Whether by reason of the fact that the Applicant's land had been consistently held and described as fixed asset in its audited accounts (with no other contrary evidence to suggest otherwise) proves this fact and discharges the burden of proof that the Applicant's land is a fixed asset?

Question 7: Whether an award of compensation arising from compulsory land acquisition should be subject to real property gains tax under Real Property Gains Tax Act 1976, instead of income tax under section 4C of the ITA?

Note that ground (ii) of Court of Appeal's Judgment i.e. Wiramuda should not bypass the statutory remedy of appeal to the SCIT, is not one of the grounds. It means that Wiramuda had conceded to it.

Counsel for IRB gave a written submission on all questions. Federal Court granted leave and allowed all the seven questions to be argued by counsel for Wiramuda, in the appeal.

However, at the hearing of the appeal, counsel for Wiramuda informed the court they would only argue on the issue of constitutionality of Section 4C; they conceded that the land was their stock in trade and therefore would not pursue on questions 5, 6 and 7.

Actually, the issue that counsel for Wiramuda chose to argue is a combination of questions 1, 2, 3 and 4. Wiramuda lost nothing by conceding questions 5, 6 and 7 as questions 5 and 6 are questions of facts and question 7 is hypothetical.

Arguments by counsel for both parties were confined to the issue of constitutionality of Section 4C.

After counsel for both parties had submitted, the Federal Court stood down and after about 15 – 20 minutes, resumed sitting and delivered its judgment orally.

The Chief Justice, presiding a 7-member panel of the court, said that both Section 4C and Section 24(1) (aa) are contrary to Article 13(2) of the Constitution. By taxing the amount of compensation received by Wiramuda the adequate compensation received by it was diminished resulting in the compensation to be inadequate under the Federal Constitution which guarantees the fundamental rights of an individual.

It is clear that the court had thought that the case was a simple one, may be because counsel had argued only on one question and the answer is just “yes” or “no”. Hence, the court did not adjourn to prepare and deliver a written judgment of the court or, better still, individual judgments of the judges.

Thus, such an important constitutional issue with far-reaching consequences was decided in a matter of minutes. I am sure the judges merely decided “yes” based on the argument of counsel. Even if the court were to produce a written judgment subsequently, it will not be a judgment written with an open mind. It will be no more than giving reasons to justify what has been decided.

I will confine my discussions to the oral judgment delivered by the learned Chief Justice, first. The judgment is based on the following premises: Article 13(2) of the Constitution guarantees adequate compensation for land acquisition; by taxing an adequate compensation, it reduces the adequate compensation to become inadequate; therefore Section 4C and Section 24(1) (aa) contravene Article 13(2) of the Constitution and are unconstitutional.

There are two things here. First the amount of compensation awarded by the Land Administrator. Appeal goes to the High Court. The issue is whether the compensation is adequate or not. Tax is not an issue at all.

If the Director General of Inland Revenue (DGIR) assesses tax on it, the taxpayer may appeal to the SCIT. The issue is whether the tax is rightly assessed or not.

The judgment assumes that the compensation awarded to Wiramuda was adequate. The truth is that a compensation could be adequate or inadequate whether it is taxed or not. Whether a compensation is adequate or not depends on how much it is awarded in a particular case. That is a question of facts to be determined in an appeal to the High Court. If it is inadequate even before or without it being taxed, Section 4C and Section 24(1) (aa) should not be blamed. Why strike down Section 4C and Section 24(1)(aa) as being unconstitutional?

If by taxing an adequate compensation given earlier, it causes the adequate compensation to become inadequate and, therefore, Article 13(2) is breached, in that case, it is the assessment that is unconstitutional and it is the assessment that should be struck out, not the law. Why strike down Section 4C and Section 24(1)(aa) as being

unconstitutional? Striking down the assessment is the function of SCIT in an appeal to it, not the court in a judicial review application.

The two sections could be used validly. One way is for the Land Administrators, having decided tentatively how much compensation he would give in a particular case, to refer the case to the IRB for "tax clearance" before making the final award. IRB will advise the Land Administrator whether the compensation is taxable and, if taxable how much based on the proposed amount of compensation. If it is not taxable, the Land Administrator will confirm his proposed amount as the compensation. If the land owner is not satisfied, he may appeal against the award as inadequate. Tax is not an issue.

If it is taxable, the Land Administer will add the amount of tax to the compensation. There will be no question of the tax reducing the compensation making it inadequate.

This procedure is somewhat similar to the procedure now practiced in a sale of land. Tax clearance is required before the Land Administer effects the transfer.

In the latter situation, the land owner/tax payer may appeal against both the award of compensation and the assessment of tax.

We have noted earlier that one of the grounds on which both the High Court and the Court of Appeal decided in favour of IRB was that Wiramuda should not bypass the statutory remedy of appeal to the SCIT under section 99(1) of the ITA (Ground (ii) of Court of Appeal's Judgment.). It means that Wiramuda had conceded to it. On that ground alone, the seven grounds should have been dismissed without argument on merits and leave to appeal should have been refused.

Both the High Court and the Court of Appeal had ruled that Wiramuda should not bypass the statutory remedy. That ground is in favor of IRB. In other words, on that ground alone, Wiramuda lost its application for judicial review and should not have been allowed to proceed further. By allowing Wiramuda to proceed, the Federal Court had disregarded the judgement of the two courts below on that issue without hearing an appeal against it, without any argument and without overruling it. That finding of the two courts stands.

There is another argument that could have been raised against Wiramuda, that is, the real issue is whether Wiramuda was awarded adequate compensation. What happens after that is irrelevant. Wiramuda may have to pay tax on it. It may have to pay its land valuers and lawyers and incur other expenses, over it. Those are subsequent events. What matters is whether the amount awarded by the acquisition authority is adequate. The remedy is appeal to the High Court. The judgment of the High Court and the Court of Appeal do not mention it. The inference is that it was not raised in the High Court nor in the Court of Appeal. If this ground was raised or if the court had thought of it and agreed with it, then there was no necessity to consider the constitutionality of Section 4C and Section 24(1) (aa). The court should only consider declaring a law unconstitutional as a last resort.

The judgment does not only affect this particular case. By saying "Yes", the court removes the right of IRB to tax such compensation, forever. IRB cannot issue a fresh assessment in another case even against a different landowner hoping to get a chance

to reopen the issue, because the law enabling a similar assessment has been struck down as unconstitutional.

I had stood for the finality of the judgment of the apex court. However, exceptions had been made. When I was Chief Justice, I tried to limit it to judgments made for lack of jurisdiction. Even using that test, I believe this case falls within that exception.

So, we should go back to the same court and try to convince it that it had committed an error of jurisdiction, law and facts resulting in unimaginable loss to IRB that it should review its own judgment.

We can put forward three grounds why leave should be given for judicial review to review this judgment:

1. The Federal Court had exceeded its jurisdiction in allowing Wiramuda to challenge the constitutionality of Section 4C ITA and Section 24(1) (aa) by way of a judicial review proceeding when the judgment of the Court of Appeal prohibiting Wiramuda to resort to judicial review proceeding in the case had not been heard and set aside by the Federal Court. The Federal Court should have heard and set aside that order first before it is seized with jurisdiction to proceed to hear the judicial review proceeding.

2. The Federal Court had committed a constitutional error when it decided that Section 4C and Section 24(1) (aa) of the ITA contravene Article 13(2) of Federal Constitution. Art 13(2) prohibits inadequate compensation, not taxation. If by taxing, an adequate compensation becomes inadequate, then it is the assessment that should be struck out, not the law.

3. The Federal Court had committed a jurisdictional error when it held that Section 4C and Section 24(1) (aa) of the ITA inherently contravene Article 13(2) of Federal Constitution. The truth is that taxation may be assessed on the compensation pursuant to the two sections without infringing Article 13(2) of Federal Constitution .

Another point I wish to make is that in a case where the validity of a law is challenged on the ground that it is unconstitutional, the Attorney General should intervene. It should not be left to the party sued to defend it. After all, it was the Executive that proposed the law, it was the Attorney General who drafted it, it was passed by Parliament and assented to by the Yang di-Pertuan Agong and, all along, it was the Attorney General who advised all the said government agencies on its constitutionality. The effect of the judgment is far reaching, not just between the two parties as in this particular case. Valid arguments may be missed resulting in permanent damage, as in this case.

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