



## High Court Rules In Favour Of Taxpayer And Sets Aside Tax Assessments

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In a decision with important implications for energy and infrastructure projects, the High Court has ruled in favour of a taxpayer on a series of substantive tax issues, including the characterisation of income, the deductibility of Sukuk financing costs and the binding effect of public rulings issued under Section 138A of the Income Tax Act 1967 (ITA).

The judgment also places clear limits on the Revenue's ability to make adjustments in the absence of statutory authority.

The taxpayer was successfully represented by the firm's Tax, SST & Customs partners, S. Saravana Kumar and Nur Amira Ahmad Azhar.

### Background

The taxpayer, a power generation company, developed a 1,440 MW power plant in Johor and raised RM 3.665 billion through sukuk financing. Following a tax audit, the Inland Revenue Board (Revenue) classified energy test payments (ETP) received from Tenaga Nasional Berhad (TNB) as pre-operational receipts taxable under Section 4(f) of the ITA. The Revenue further disallowed deductions for sukuk interest and unit trust fund (UTF) tax credits and added back provisions for liquidated damages and restoration costs.

The taxpayer commenced judicial review proceedings to challenge the assessments.

### The Revenue's Contention

The Revenue argued that the ETP was received prior to the commencement of operations and therefore constituted "other income" assessable under Section 4(f) of the ITA.

In relation to the sukuk financing, the Revenue contended that the interest expense was capital in nature, on the basis that the funds were raised for working capital purposes. As such, the expenditure was said not to satisfy the requirement under Section 33(1)(a) that it be wholly and exclusively incurred in the production of gross income.

The Revenue also maintained that the taxpayer had failed to substantiate its UTF tax credit claim, asserting that the dividend vouchers provided did not contain the particulars required under Section 44 of the Finance Act 2007.

Finally, the Revenue added back provisions for liquidated damages and restoration costs, citing the absence of disclosures relating to total project revenue and total project cost in the taxpayer's audited accounts.

### **The Taxpayer's Contention**

#### **(i) Energy Test Payments**

The taxpayer submitted that the ETP constituted business income under Section 4(a) of the ITA, arising from its ordinary trading activities of generating and supplying electricity to TNB. Relying on established authority, the taxpayer argued that where receipts are derived from the core operations of a business, they should be assessed under the business income limb even if other charging provisions may appear to overlap.

On this basis, the ETP was said to be ancillary and incidental to the taxpayer's principal activity as an independent power producer, sharing the same commercial character as its ordinary trading income.

#### **(ii) Deductibility Of Interest Expense**

The taxpayer contended that the sukuk proceeds were deployed in the course of its business and that the related interest expense was therefore incurred wholly and exclusively in the production of gross income. Section 33(1)(a) of the ITA draws no distinction between capital and revenue financing where funds are applied to income-producing activities.

The taxpayer submitted that judicial authority consistently supports the deductibility of interest where borrowing is undertaken for business purposes.

#### **(iii) Deductibility Of The Unit Trust Fund Tax Credit Claim**

In relation to the UTF tax credit, the taxpayer relied on Section 110(9A) of the ITA and Public Ruling No. 5/2013, which permits the set-off of tax paid at the unit trust level. The taxpayer argued that responsibility for issuing tax certificates rests with the unit trust manager, and that Section 44 of the Finance Act 2007 does not prescribe any mandatory form for dividend vouchers.

Crucially, the taxpayer maintained that where a public ruling is correctly applied, Section 138A obliges the Revenue to give effect to it.

#### **(iv) Provisions For Liquidated Damages And Restoration Costs**

As regards the provisions for liquidated damages and restoration costs, the taxpayer pointed out that no deductions had been claimed in its tax computation. The decision to add back these amounts was therefore said to lack any legal or factual foundation, resulting in an impermissible enrichment of the Revenue.

## **The High Court's Ruling**

The High Court allowed the judicial review application in full.

On income characterisation, the court held that the ETP formed part of the taxpayer's business income under Section 4(a), being directly linked to its core activity of generating and supplying electricity.

The court also found that the interest expense on the sukuk was deductible under Section 33(1)(a), emphasising that the decisive factor is the use of the funds in income-producing activities, rather than the capital or revenue nature of the financing.

With respect to the UTF tax credits, the court held that Public Ruling No. 5/2013, issued pursuant to Section 138A, is binding on the Revenue where correctly applied. The denial of the set-off therefore had no legal basis.

Finally, the court ruled that the Revenue had acted without statutory authority in adding back provisions that had not been claimed. In doing so, it had contravened Article 96 of the Federal Constitution, which prohibits the imposition or collection of tax without legal authority.

## **Conclusion**

The decision represents a significant clarification for taxpayers in the energy and infrastructure sectors. It confirms that receipts arising from core operational activities fall within Section 4(a), that sukuk interest incurred in the course of business is deductible under Section 33(1)(a), and that public rulings issued under Section 138A bind the Revenue as a matter of law.

More broadly, the judgment underscores a judicial willingness to insist on legal discipline in tax administration. For businesses undertaking large, capital-intensive projects, the ruling offers a measure of certainty that commercial substance, statutory limits and published guidance will be given due weight in resolving tax disputes.

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