

When the Taxman Cometh: Perils and Pitfalls for the Modern-Day Director



by Chris Toh Pei Roo

As of 31 December 2019, the total number of companies registered in Malaysia is 1,346,181.¹ Under the current Companies Act 2016, private companies must have at least one director, while public companies are still required to have at least two directors.² This means that as of 31 December 2019, there would have been at least 1,346,181 company directors in Malaysia, with the actual numbers certain to be far higher.

Directorships are perceived by many as an emblem of corporate success, conjuring up an image of well-heeled businesspeople in corner offices receiving lucrative remuneration. Most directors presumably have at least a broad understanding of their general duties, among which are to act in good faith in the best interest of the company, and to exercise reasonable care, skill and diligence.³ What many may not be aware of are their duties, responsibilities and perhaps most tangibly, liabilities that they may have in respect of the companies' tax affairs.

General principles: Company as separate legal entity

Many directors know that they cannot generally be made personally liable for the company's debts. It is trite that a company is a separate

legal entity from its shareholders and directors.⁴ A commonly known exception is where the director has given a personal guarantee for the company's obligations.

Otherwise, the court may only impose personal liability on directors and shareholders by lifting the corporate veil where special circumstances exist; such as in cases where there has been fraud or some other inequitable or unconscionable conduct.⁵ Such conduct was found, for instance, in *RDS Bina*.⁶ Here, RDS Bina (the plaintiff) was a construction contractor that had been owed sums by Springs Court Sdn Bhd (the company). After negotiations, the company had signed a settlement agreement to pay certain sums to the plaintiff.

¹ Based on 2020 statistics published by the Companies Commission of Malaysia (SSM) <https://www.ssm.com.my/Pages/Publication/Statistics/Companies%20and%20Business%20Registered/Company%20and%20Business%20Registered%20Statistic%20for%202020/Company-and-Business-Registered-Statistic-2020.aspx>

² Companies Act 2016, s 196(1). Prior to 31 January 2017, the law required a minimum of two directors for every company: Companies Act 1965, s 122(1)

³ Companies Act 2016, s 213; Such duties apply even to nominee directors; see Companies Act 2016, s 217

⁴ *Bumiputra-Commerce Bank Berhad v Augusto Pompeo Romei & Anor* [2014] 6 CLJ 17; *Salomon v Salomon* [1896] UKHL 1

⁵ *Law Kam Loy & Anor v Boltex Sdn Bhd & Ors* [2005] 3 CLJ 355

⁶ *RDS Bina Sdn Bhd v Ong Chin Hoe & Anor* [2014] 5 CLJ 639



The company, however, failed to pay and it later transpired that the company has also been dissolved. The plaintiff sued the company's directors and shareholders, and persuaded the court that they ought to be imposed with personal liability. Among others, the defendants were found to have hidden the steps taken for deregistration from the plaintiff and the court, and have also stated untruths in their statutory declarations made to the Companies Commission of Malaysia (or SSM) for the deregistration of the company.

Duties to perform acts required under Income Tax Act 1967

Under the Income Tax Act 1967 (ITA), the responsibility for doing all acts and things required of a company lies jointly and severally with the company's manager or other principal officers, the directors, the secretary, and any other persons exercising such function.⁷ The ITA imposes various obligations on companies, the most obvious of which are to file accurate tax returns.⁸ Failure by the company to do so is a prosecutable offence. Upon conviction, the punishments for such failures are:

Failure to file tax returns ⁹		Incorrect returns ¹⁰
For any one year of assessment (YA)	For 2 YAs or more	Fine of RM1,000 to RM10,000; and a special penalty of double the amount of tax undercharged in consequence of the incorrect return or information.
Fine of RM200 to RM20,000, or imprisonment for up to six months, or both.	Fine of RM 1000 to RM20,000, or imprisonment for up to six months, or both; and a special penalty equal to treble the amount of tax chargeable for those years.	
In lieu of prosecution, the DGIR may require a penalty to be paid.		
Penalty equal to treble the amount of the tax payable for that year. ¹¹		Penalty equal to the amount of tax undercharged in consequence of the incorrect return or information. ¹²

Directors' liability for company taxes

Unlike the company's managers, other principal officers or secretaries company directors can also be made personally liable for the company's taxes,¹³ provided that the relevant conditions are met. Director means any person who:¹⁴

- (a) occupies the position of director (by whatever name called), including any person concerned in

the management of the company's business; and

- (b) controls at least 20% of the company's ordinary share capital, whether on his own or together with his "associates", and whether directly or indirectly.¹⁵

"Associates" means, among others: husband or wife, parent or remoter forebear, child or remoter issue, brother, sister and partner.¹⁶ In other words,

⁷ ITA, s 75

⁸ ITA, s 77A

⁹ ITA, s 112

¹⁰ ITA, s 113

¹¹ ITA, s 112(3)

¹² ITA, s 113(2)

¹³ ITA, s 75A

¹⁴ ITA, s 75A(2)

¹⁵ Prior to 2014, the law required 50% shareholding for personal liability to be imposed. The lowering of the threshold to 20% has resulted in an immediate increase in the number of actions being brought against company directors by the tax authorities. See Habhajan Singh, 'More company directors hauled to court for not paying taxes' *The Malaysian Reserve* (20 March 2018) <https://themalaysianreserve.com/2018/03/20/more-company-directors-hauled-to-court-for-not-paying-taxes/>

¹⁶ ITA, s 139(7)(a)

directors cannot circumvent personal liability by splitting up share ownership with immediate family members.¹⁷

Directors could also be barred from leaving Malaysia for the company's failure to pay its taxes,¹⁸ although this is perhaps of lesser consequence in light of travel restrictions in the current pandemic.

The Inland Revenue Board (**IRB**) may recover unpaid taxes from directors through civil proceedings commenced by the government of Malaysia,¹⁹ in which it will also apply for summary judgment from the courts.²⁰ In such cases, the usual position that the defendant can avoid summary judgment by raising triable issues does not apply.²¹ This is because the courts cannot entertain any plea that the amount of tax sought is excessive, incorrect or under appeal.²² The courts, however, retain the discretion to grant a stay provided that the defendant succeeds in showing special circumstances.²³ If a summary judgment is entered, the IRB may also commence bankruptcy proceedings against the taxpayer should the judgment debt remains unpaid.

Directors' liability cannot be retrospectively imposed

An important question that arose is whether directors' liability could be retrospectively imposed. To illustrate, if for instance a person had become

a director (and acquired the requisite 20% shareholding) of a company in 2020, could he be made liable for outstanding or newly assessed taxes of the company for e.g. in YAs 2016, 2017 and 2018?

The IRB appears to think so.²⁴ The courts have, however, firmly rejected this proposition, most recently at the Court of Appeal (**CA**) in *Government of Malaysia v Mahawira Sdn Bhd & Anor*.²⁵ Here, the IRB had issued tax assessments against the company on 30.10.2014 for taxes relating to YAs 2001 to 2004. The IRB, through the government of Malaysia, then sued the company and its director for these taxes even though the director had only been a director since 19.12.2003. The CA held that the director could not be held liable, stating that:

"We could not find someone who has not assumed the role as a director and thereby willing to take the responsibilities, should shoulder the burden undertaken by any companies, including paying the tax. Holding anyone responsible, when they have not reached the stage to even ponder on the duties as a director, let alone actually undertake the post, can no doubt be harsh and unreasonable. Anyone in that sense should only be held liable if he or she at the material time

has already been appointed as a director."

[Emphasis added.]

Perils of directorships are very real

It is impossible to overstate the significance of the possible liabilities that directors may face under the ITA. A 2018 news article titled "More company directors hauled to court for not paying taxes"²⁶ conjures the image of recalcitrant and errant tax evaders faced with the righteous wrath of the tax authorities. However, this may not necessarily always be the case.

Tax professionals would note that the nature of the ITA requires taxes to be payable on issuance of an assessment, whether or not one appeals against it.²⁷ In other words, tax liabilities may arise on what is essentially an administrative act, the correctness of which would not have been determined by the courts.

A good, conscientious, law-abiding director may be excused for believing that he can easily remain on firm ground simply by following judicial guidance, or the advice of tax professionals in the company's tax affairs. However, past cases would suggest that even this is no guarantee. To give three examples:

- 1) In *T v Ketua Pengarah Hasil Dalam Negeri*,²⁸ the IRB disallowed

¹⁷ It has been noted, however, that 'Associates' as defined in s 139(7) of the ITA does not include in-laws, e.g. parents-in-law and/or siblings-in-law

¹⁸ ITA, s 104(1) and (6)

¹⁹ ITA, s 106

²⁰ Pursuant to O 14, r 1 of the Rules of Court 2012

²¹ *Government of Malaysia v Mohd Najib Haji Abd Razak* [2020] 1 LNS 754. See, however, *Kerajaan Malaysia v Rohana Abu* [2018] 1 LNS 151, where the defendant taxpayer successfully raised a triable issue

²² ITA, s 106(3)

²³ *Kerajaan Malaysia v Berjaya Times Square Sdn Bhd* [2018] 1 LNS 720

²⁴ For further discussion, see our LHAG Update of 25 March 2021, available at https://www.lh-ag.com/wp-content/uploads/2021/03/Directors-Liability-under-ITA-1967-Cannot-be-Retrospectively-Imposed_LHAG-Insights-20210325.pdf

²⁵ W-01(NCVC)(W)-152-03/2019. See also the High Court's decisions in *Kerajaan Malaysia v Rohana Abu* [2018] 1 LNS 151 and *Kerajaan Malaysia v Isqandar Dzulkarnaen Putra bin Salehudin and Norsiah binti Mokri* [2018] 1 LNS 267

²⁶ Habhajan Singh, *supra* n 15

²⁷ ITA, s 103

²⁸ See our LHAG Update of 4 March 2021, available at https://www.lh-ag.com/wp-content/uploads/2021/03/T-v-Ketua-Pengarah-Hasil-Dalam-Negeri_LHAG-Insights-20210304.pdf

certain expenditure incurred by the company, relying on a decision of the Special Commissioners of Income Tax (**SCIT**). The company through its tax agents informed the IRB that the High Court had already reversed the SCIT's decision and held that such expenditure is deductible. Nevertheless, the IRB proceeded to issue tax assessments and even sued the company and its director in civil recovery proceedings.²⁹

- 2) In *S v Ketua Pengarah Hasil Dalam Negeri*,³⁰ the IRB made transfer pricing adjustments on the taxpayer by adjusting its results to the median, resulting in significant tax liabilities for the taxpayer. It did so despite the fact that international guidelines and practice do not require such an adjustment to be made.³¹
- 3) In *SMSD v Ketua Pengarah Kastam & Ors*,³² the Royal Malaysian Customs Department (**Customs**) issued Bills of Demand for import duties and excise duties, on alleged breaches by the taxpayer of a condition in its duty-free licence. The Court of Appeal quashed the decision of Customs and held that the purported condition was illegal. Customs' application for leave to appeal to the Federal Court was also dismissed. Disturbingly, however, Customs proceeded to bring 600 criminal charges against the company and its directors based on purported breaches of the same conditions.³³

Concluding thoughts

Under such circumstances, one could perhaps be driven to placate the IRB by adopting an extreme approach, possibly by erring on the side of caution and claiming no tax deductions at all. Again, even this may not be sufficient as there are cases where companies have been slapped with penalties even when their prior returns resulted in an **overstatement** of income. In any event, such a zealous approach would no doubt come into conflict with the director's duties to act in the company's best interests.

In fact, even directors of dormant companies that have never commenced operations or even opened a bank account cannot expect to be safe, for the taxman may still come a-knocking, and even a wrong knock would still bring with it all the might and powers that the IRB could bring to bear under the ITA.

In all such cases, it is only to the courts that companies and their directors must turn and from which justice ought to be demanded without hesitation. **LH-AG**

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²⁹ The High Court has granted leave for the company to commence judicial review against the IRB.

³⁰ See our LHAG Updates of 10 June 2021 and 5 February 2021, available at https://www.lh-ag.com/wp-content/uploads/2021/06/DGIRs-Powers-to-Make-Transfer-Pricing-Adjustments-Under-s-140A-Income-Tax-Act-1967-_LHAG-Insights-20210610.pdf and https://www.lh-ag.com/wp-content/uploads/2021/02/Landmark-Decision-on-Transfer-Pricing-Section-140A-Income-Tax-Act-1967-and-Income-Tax-Transfer-Pricing-Rules-2012-_LHAG-Insights-20210205.pdf

³¹ The SCIT has set aside the assessment earlier this year and reminded that tax authorities have to act properly and in good faith.

³² See our LHAG alert of 18 June 2020, available at <https://www.lh-ag.com/wp-content/uploads/2020/06/Customs-Bills-of-Demand-Against-Taxpayer-Quashed-by-CA-LHAG-alert-20200618.pdf>

³³ Ida Lim, 'Company: Customs' 600 charges on Perak duty-free store's operator despite failed appeal bid at Federal Court suggests prosecutorial misconduct, malicious prosecution' *Malay Mail Online* (27 February 2021) <https://www.malaymail.com/news/malaysia/2021/02/27/company-customs-600-charges-on-perak-duty-free-stores-operator-despite-fail/1953316>. As of the date of publication, these charges have yet to be heard.