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Appealing Against IRB's Advance Ruling

On 29.10.2019, a Federal Court panel chaired by the Chief Justice of Malaysia unanimously granted leave to a taxpayer in respect of the following questions:

- Whether an advance ruling issued under Section 138B of the Income Tax Act 1967 (**ITA**) is a decision that could adversely affect the applicant within the meaning of Order 53 Rule 2(4) of the Rules of Court 2012;
- In the event of a conflict, whether the definition of “royalty” in a double taxation agreement (**DTA**) shall prevail over that in Section 2(1) of the ITA.

The taxpayer was successfully represented by our Tax, SST & Customs partners, Rosli Dahlan and S Saravana Kumar, together with associate, Edmund Yee.

Background Facts

The taxpayer, a Malaysian resident, is in the business of purchasing and distributing products owned by other companies. The taxpayer contemplated executing a distribution agreement (**Distribution Agreement**) with a developer based in Europe for the right to distribute certain products developed by the latter (**Products**). Pursuant to the terms of the Distribution Agreement, the taxpayer is required to make payment (**Distribution Fee**) to the developer for each copy of the Products purchased and distributed in Malaysia. The taxpayer applied for an advance ruling for a determination that the Distribution Fee is not a form of “royalty” under the Malaysia-Netherlands DTA and, thus, not subject to withholding tax under Section 109(1) of the ITA.

The IRB issued an advance ruling (**Advance Ruling**) stipulating that the Distribution Fee is “royalty” under Section 2(1) of the ITA and, therefore, should be subject to withholding tax. The taxpayer submitted that the Advance Ruling is erroneous as it runs contrary to the definition of “royalty” under the DTA. Pursuant to the definition under the DTA, the Distribution Fee is not “royalty” as it was not paid in exchange for the copyright or know-how of the Products.

Judicial Process

The taxpayer commenced a judicial review application at the High Court to set aside the Advance Ruling. The High Court held that the taxpayer had been adversely affected by the Advance Ruling and allowed the taxpayer's application on the basis that the definition of "royalty" under the DTA shall prevail over that in the ITA.

Subsequently, the Court of Appeal reversed the High Court's decision on, among other things, the ground that the application filed by the taxpayer was premature. The Court of Appeal took the view that the taxpayer had not been adversely affected by the Advance Ruling as the ruling has no tax implication on the taxpayer. Despite its ruling, the Court of Appeal granted an order to stay the Advance Ruling pending the taxpayer's leave application before the Federal Court.

Hearing Before The Federal Court

The Federal Court agreed with our arguments that the Court of Appeal's decision gave rise to novel points of law which are of public importance and granted leave to the taxpayer to challenge the decision of the Court of Appeal. The Federal Court also granted an order to stay the effect of the Court of Appeal's decision and the Advance Ruling pending the disposal of the substantive appeal at the Federal Court.

Conclusion

The two questions pending before the Federal Court would provide an authoritative guidance to taxpayers on the availability of judicial review to challenge an adverse advance ruling issued by the IRB and determine once and for all which definition of "royalty" prevails when there is a conflict between the ITA and a DTA.

If you wish to challenge any tax assessments or decisions by the IRB, including advance rulings, please contact our Tax, SST & Customs partners, **Datuk D P Naban** and **S Saravana Kumar**, at tax@lh-ag.com

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