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Connected Persons Under the Goods and Services Tax Act 2014

Would two companies with the same common non-executive director be regarded as connected persons for the purposes of the Goods and Services Tax Act 2014 (“**GST Act**”)?

The Law

Paragraph 1(2) of the Third Schedule of the GST Act provides that the value of the supply of goods and services shall be its open market value where:

- (a) a taxable person is connected with the person receiving the supply;
- (b) the value of a supply is less than its open market value; and
- (c) the supply is a taxable supply and the person receiving the supply is not entitled to input tax credit.

Paragraph 2(1)(a) of the Third Schedule of the GST Act provides that a person shall be deemed to be connected if they are officers or directors of one another's business.

Whether Two Companies with a Common Non-Executive Director are Connected Persons

Presently, there is no Malaysian case in relation to the interpretation of Paragraph 2(1)(a) of the Third Schedule. Guidance however, can be drawn from the English High Court case of *R (on the application of Botswana Meat Commission (UK) Holdings Limited) v Rural Payments Agency [2005] EWHC 1163 (Admin)*. This case concerns the issue of whether two independent companies, i.e. Botswana Meat Commission (UK) Holdings (“**BMC**”) and Meat Corporation of Namibia (Netherlands) BV (“**MCN**”) are “related persons” by virtue of having a common director. Article 143 of Commission

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Regulation (EEC) No 2454/93 on “related persons” is a similar provision to Paragraph 2(1)(a) of the Third Schedule.

The facts of the *Botswana Meat* case are as follows. BMC imported chilled and frozen beef from Botswana into the United Kingdom and elsewhere. The managing director was a Mr Ove Nielsen. At the material time, Mr Nielsen was also the managing director of MCN. Both BMC and MCN have for some years been importing frozen beef into the EU. Both BMC and MCN qualified to apply for licences to import frozen beef at a reduced import duty. However, there was an important qualification. The relevant regulations provided that applicants for the licence must not be related. Hence, BMC’s licence application was refused by the Rural Payments Agency on the basis that both BMC and MCN shared a common director.

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The Court held that there was indeed a deemed relationship between BMC and MCN on the basis that they have a common director and stressed that a purposive approach should always be applied in interpreting any EU regulation. However, the Court did acknowledge that when read literally, Article 143(1)(a) applied to the individual and not to the businesses of which they were officers or directors:

“Taken literally, art 143(1)(a) applies to persons and not to the businesses of which they are officers or directors. This led the Dutch appeal panel to reach the following conclusion: -

“Even though the companies mentioned in the contested decision . . . have in common that Mr Nielsen is their Director, they are not connected as per Article 143(1)(a) . . ., which formed the basis of the contested decision . . . This is a logical conclusion based on the wording of this Regulation, because no persons have been found who are managers or Directors of each other’s companies. This presupposes that there are two people, whereby A is a manager or Director of B’s company and B is a manager or Director of A’s company.

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This is quite a different situation than the one whereby two companies share the same Director, or in any case as long as we are not dealing with each other's companies."

The 2003 Regulations must prevail. The wording of art 9(5) is clear and, as is obvious, an applicant must include both an individual and a corporate entity. The reference to management and staff of an applicant shows beyond any doubt that the literal meaning of art 143 cannot apply. Thus the construction applied by the Dutch panel - its 'logical conclusion' based on art 143 - is in my judgment wrong. The contrary was not argued before me by Mr Ramsden. Accordingly, there is a deemed relationship within the meaning of art 143 where applicants have common directors or officers and art 143(1)(a) must be construed to achieve this for art 9(5) to make any sense..."

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Our View

While our Federal Court has recognised that courts may take a purposive approach in the interpretation of statutes, including taxing statutes, such an approach should be adopted to promote the object or purpose of the statute.

In ***Palm Oil Research and Development Board Malaysia & Anor v Premium Vegetable Oils Sdn Bhd [2004] 2 CLJ 265***, the Federal Court held that there is a statutory recognition for courts to take a purposive approach in the interpretation of statutes, including taxing statutes. The Court held that the correct approach to be adopted is that set out in ***Mangin v Inland Revenue Commissioner [1971] AC 739***:

"First, the words are to be given their ordinary meaning. They are not to be given some other meaning simply because their object is to frustrate legitimate tax avoidance devices. As Turner J said in his (albeit dissenting) judgment in Marx v Inland Revenue Commissioner [1970] NZLR 182 at 208, moral precepts are not applicable to the interpretation of revenue statutes.

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Secondly, '...one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption so to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used'. (Per Rowlatt J in *Cape Brandy Syndicate v Inland Revenue Commissioners* [1921] 1 KB 64 at 71, approved by Viscount Simons LC in *Canadian Eagle Oil Co Ltd v Regeim* [1945] 2 All ER 499; [1946] AC 119).

Thirdly, the object of the construction of a statute being to ascertain the will of the legislature, it may be presumed that neither injustice nor absurdity was intended. If therefore a literal interpretation would produce such a result, and the language admits of an interpretation which would avoid it, then such an interpretation may be adopted.

Fourthly, the history of an enactment and the reasons which led to its being passed may be used as an aid to its construction."

In addition, the court is under a duty to adopt an approach that does not create injustice or an absurd result:

"... 79 In my respectful view, s 17A of the Interpretation Acts 1948 and 1967 neatly fits into and is complementary with the third principle in the judgment of Lord Donovan. Hence, the governing principle is this. When construing a taxing or other statute, the sole function of the court is to discover the true intention of Parliament. In that process, the court is under a duty to adopt an approach that produces neither injustice nor absurdity: in other words, an approach that promotes the purpose or object underlying the particular statute albeit that such purpose or object is not expressly set out therein. Imposing a tax by means of subsidiary legislation on a person not identified in the parent Act produces an absurd and unjust result and therefore does not promote its purpose or object."

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Hansard does not reveal any discussion or debate on Paragraph 2(1)(a) of the Third Schedule. Accordingly, Parliament's true intention in relation to Paragraph 2(1)(a) of the Third Schedule cannot be proved or ascertained. In this regard, suggesting that independent companies are connected by virtue of having a common non-executive director will not in any way promote the underlying purpose or object of Paragraph 2(1)(a) of the Third Schedule. Instead, such an approach would produce injustice or an absurd result as it is common for non-executive directors to hold office in different companies which are independent of each other.

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Conclusion

Based on a literal interpretation of Paragraph 2(1)(a) of the Third Schedule, the paragraph only applies to persons or individuals and not to the businesses of which they are officers or directors. Hence, it appears that two independent companies will not be connected merely due to the fact that they have a common non-executive director.

Please contact us at tax@lh-ag.com if you have any queries in respect of this topic or GST matters.

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