LH AG
ADVOCATES AND SOLICITORS

YEAR IN REVIEW:

LHAG'S 10 NOTABLE TAX CASES IN 2023

Foreword

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Taxation law has the most unfortunate reputation of being dull and dry, which, in my opinion, is far removed from the truth. It is, in fact, one of the fastest-moving areas of practice a practitioner may encounter, with annual changes in the law being almost guaranteed, not only to take account of court decisions but also changing governmental policies and economic environments.

2023 proved to be an exciting year for the Malaysian tax regime, as well as LHAG's Tax Customs & Trade team. The year saw two Finance Bills being tabled and passed by the Unity Government, the first being re-tabled and the second to set the tone for 2024. The most notable changes included:

- the introduction of incentives for the promotion of electric vehicles,
- the introduction of capital gains tax,
- the introduction of tax incentives for the agriculture and food industry to combat food shortages and steep prices,
- the shift from traditional paper invoicing to e-invoicing,
- the introduction of OECD's Global Minimum Tax mechanisms into the Income Tax Act 1967,
- the Government's promotion of ESG practices and renewable energy via tax deductions,
- the Government's promotion of Malaysia's New Industrial Master Plan 2023 supported by tax incentives,
- the announcement of the implementation of low-value goods tax on 1.1.2024 that was previously postponed,
- the gazetting of the new Income Tax (Transfer Pricing) Rules 2023,
- the controversial delisting of nicotine from the Poisons List as part of the government's "due process" to enable the taxation of e-liquids with nicotine, and,
- the government's proposal to introduce high-value goods tax (yet to be implemented).

The courts too were busy with tax cases in 2023. Recent decisions provided much-needed clarity and/or confirmation of the legal principles to be applied in complying with the law. I am delighted to introduce this special alert, in which we summarise 10 of our most interesting and notable cases decided in 2023.

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Index

Table of Contents

1. SEIWA PODOYO SDN BHD V KPHDN (COURT OF APPEAL)

Brief Facts

The Taxpayer has been in the business of manufacturing, assembling, and trading plastic injection-moulded products since 1993. In 2008, the appellant decided to diversify its business into plastic casings for ink cartridges. Thus, in 2009, the Taxpayer purchased new machinery and equipment for that purpose and claimed reinvestment allowance ("RA") on the capital expenditure incurred. However, in 2015, the IRB disallowed the Taxpayer's RA claims in YA 2009 and raised an additional assessment for YA 2010 in 2015. The IRB's basis for raising the additional assessment is that, based on the IRB's public ruling, the taxpayer's expenditure does not fall within the meaning of 'diversifying' under Schedule 7A of the Income Tax Act 1967.

IRB's position:

a) The notice of assessment dated 25.6.2015 was issued for YA 2010 and not YA 2009. There was no assessment raised for YA 2009. As such, the notice of assessment was issued within time-bar period of 5 years.

b) The IRB's act of disallowing RA for YA 2009 does not constitute an 'assessment' pursuant to Section 93 of the ITA.

c) The Taxpayer was negligent because it had made a declaration of compliance with public rulings in its Form C when it did not (according to the IRB). Public Rulings have the force of law.

d) The Taxpayer is only entitled to claim RA under the category of "diversifying" provided that the Taxpayer continues to produce its existing product, i.e., plastic components for the automotive sector. The Taxpayer in this case ceased production of its existing product and disposed of the machinery for the production of the existing product. Following from that, the Taxpayer did not "diversify" under Schedule 7A of the ITA.

Taxpayer's position:

a) A taxpayer's eligibility for RA must be determined for the YA in which the expenditure is made. Any adjustment by the IRB must be made to the year of assessment in which the RA was claimed. Therefore, the time-bar is calculated from the year where the RA was claimed, and not the year the assessment was issued. The assessment was time-barred pursuant to Section 91(1) of the ITA.

b) The IRB's act of disallowing RA claimed in YA 2009 is an assessment and attracts the application of Section 91(1) i.e., limitation period. The superior courts have held that "assessments" do not refer to the papers or notices issued by the IRB. An assessment is the official act or operation of the IRB to determine the taxes payable. In fact, past cases have shown that the IRB themselves have taken the position that an assessment is not confined to a notice.

c) Public Rulings issued by the IRB are merely the **IRB's own interpretation of the statutes, have no force of law and are not binding on the taxpayers**. In fact, Section 138A(3) allows taxpayers the choice of whether to apply public rulings or otherwise. If the taxpayers choose to apply the public rulings, the IRB is estopped from not complying with their own Public Rulings. Further, **Public Rulings cannot in any way adversely modify or restrict tax incentives** granted by Parliament through primary legislation to taxpayers. When there is doubt or ambiguity on whether a taxpayer is entitled to claim for tax incentive, the law is to be read liberally in the taxpayer's favour.

d) In adopting a purposive approach in interpreting the ITA and looking at the wordings used as well as giving the ordinary meaning to the word, it is clear that 'diversify' includes **not only enlarging the number of products, but also changing the type of products produced**. The IRB's contention that the Taxpayer must continue to maintain an existing product while creating an additional product is therefore erroneous. There is also no specific requirement in the ITA that a Taxpayer must maintain its existing product while diversifying into a new product to be eligible for RA.

e) **<u>The IRB must provide reasons when imposing a penalty</u>**. Further, penalties should not be imposed when the dispute arises as a result of a technical adjustment (i.e., a difference in interpretation of legislation between the Taxpayer and the IRB).

<u>The High Court's Findings</u>:

Upon evaluation of the relevant statutory provision and authorities, the High Court held that:

a) A public ruling cannot in any way adversely modify or restrict tax incentives granted by Parliament through primary legislation to taxpayers. When there is doubt or ambiguity on whether a taxpayer is entitled to claim a tax incentive, the law is to be read liberally in the taxpayer's favour.

b) The phrase "diversifying" must be understood in its plain and ordinary meaning, which is to "enlarge or vary its range of products or field of operation." In adopting a purposive approach in interpreting the ITA and considering the wordings used as well as giving the ordinary meaning to the word, it is clear that "diversify" includes not only enlarging the number of products, but also changing the type of product produced. The IRB's contention that the Taxpayer must continue to maintain an existing product while creating an additional product is therefore erroneous. The definition of "diversifying" cannot be restricted to only enlarging the number of products because to "diversify" means to "enlarge or vary its range of products", which is exactly what the Taxpayer has done.

c) The diversifying activity undertaken by the Appellant is an activity within its core business activity of plastic injection moulding. The two products are clearly related by virtue of having the same raw material and manufacturing process within the plastic injection moulded products industry.

d) Based on the Budget Speech 1991, RA is "given on reinvestments in related products." There is no requirement or limitation that the "related product" in question must be "additional or new" in relation to an "existing" product. RA will also be given for expansion, modernisation, and diversification activities undertaken by a manufacturing company to diversify their products. It is further clear that there is no indication whatsoever that the intention of Parliament in introducing RA is to encourage companies in Malaysia to only expand or enlarge their production and not to vary their production activities as submitted by the IRB. It is also apparent from the Budget Speech 1991 that that the government had decided to widen the scope of RA to not only encourage companies in Malaysia to expand or enlarge their production but also to diversify their products.

e) Each word in a statute must be given significance. As such, it cannot be said that "diversifying" has the same meaning with "expanding". It is clear that Parliament had intended to allow RA for both circumstances of expanding production and diversification products.

f) The SCIT had erred in dismissing the Taxpayer's appeal on the premise of the Appellant's non-compliance with the Public Ruling when the Public Ruling has no force of law.

g) The fact that the Appellant had carried forward the unutilised RA claimed in YA 2009 to YA 2010 does not mean that YA 2010 may be adjusted. Any adjustment must be made to the year of assessment in which the RA was claimed, and in the present matter, it was YA 2009.

h) Section 91(1) of the ITA allows the IRB to lift the time bar if there was fraud, negligence, or wilful default. However, the IRB had failed to allege nor prove fraud, negligence, or wilful default despite the burden being placed on the IRB to do so.

i) In any event, the SCIT should not have found that the Appellant was negligent as the issue of "negligence" was not contended or raised by the Revenue. It is trite law that the court is not entitled to decide on an issue not raised by the parties. Any decision based on issues not raised should be set aside on appeal. Further, the legislation does not give the SCIT *suo moto* jurisdiction to apply Section 91(3) of the ITA when the Revenue has not sought to apply it.

<u>The Court of Appeal's Decision</u>:

The Court of Appeal dismissed the IRB's appeal and unanimously ruled in favour of the Taxpayer.

The Court of Appeal further indicated that a written grounds of judgment will be provided. Pending further written grounds by the Court of Appeal, this decision will be one of the landmark tax cases for taxpayers as it addresses common issues often encountered when assessments are issued by the DGIR, such as time-barred assessment, reinvestment allowance, and penalties.

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2. KPHDN v TRANSOCEAN DRILLING SDN BHD (Court of Appeal)

Brief Facts

Transocean Drilling Sdn Bhd filed its tax returns for years of assessment YA 2011 and 2012 based on its management accounts ("Original Returns") within the prescribed statutory timeframe. Subsequently, the Taxpayer revised the Original Returns based on its audited accounts ("Revised Returns") and filed the Revised Returns in YA 2014. Based on the Revised Returns, the Taxpayer had overdeclared and overpaid taxes for YA 2012 by RM 787,383.25, and underdeclared and underpaid taxes for YA 2011 by RM 462,441.25.

Revenue's Position

a) The Revenue effectively treated the Original Returns as nullities – as if they had never been filed by the Taxpayer. This is on the basis that the Original Returns allegedly breached Section 77A(1) of the Income Tax Act 1967 ("ITA") as they were computed based on the audited accounts.

b) Premised on the above, the Revenue imposed penalties pursuant to Section 112(3) of the ITA for failure to furnish a tax return instead of imposing a penalty under Section 113(2) of the ITA for filing an incorrect tax return. Section 112(3) of the ITA provides that where Section 77A(1) of the ITA has been breached, and no prosecution has been instituted under Section 112(1) of the ITA, Revenue may impose a penalty equal to three times the amount of the tax payable for that YA.

c) The Revenue imposed penalties not only on taxes underdeclared and underpaid for YA 2011 but also on taxes that had been overdeclared and overpaid for YA 2012, totalling RM 2,489,133.21.

Taxpayer's Positions

The Taxpayer contended that the Revenue is not allowed to impose penalties under Section 112(3) of the ITA based on the following reasons:

a) Section 112(3) of the ITA can only be invoked by the Revenue if it did not prosecute the taxpayer for a breach of Section 77A(1) of the ITA under Section 112(1) of the ITA. Therefore, Section 112(3) of the ITA, which entails criminal implications, must be construed strictly in the context of a breach of Section 77A(1) of the ITA. Section 77A(1) of the ITA merely requires the filing of tax returns: (1) in the prescribed form; and (2) within the prescribed time, which the Taxpayer had complied with. There is no requirement for tax returns to be filed using audited accounts under Section 77A(1) of the ITA. Accordingly, the Taxpayer did not breach Section 77A(1) of the ITA.

b) There is no provision in the ITA allowing the Revenue to invalidate a return. Rather, Section 90 of the ITA provides that a return filed by a taxpayer is deemed assessed by the Revenue, and Section 143(1) and Section 143(2)(c) of the ITA expressly preserve the validity of assessments notwithstanding any mistakes, defects, or omissions therein.

The High Court's Findings:

Upon evaluation of the relevant statutory provision and authorities, the High Court held that:

a) The SCIT had erred in holding that Section 112(3) of the ITA applies to any non-compliance with Section 77A(3)(b) of the ITA. Non-compliance with Section 77(3)(b) of the ITA was only penalised with effect from 31.12.2015 under Section 120(1)(h) of the ITA.

b) Based on the scheme of the ITA and language of Sections 112(3), 113, 114 & 120(h), it is clear that the Respondent could only impose a penalty under Section 112(3) for breach of Section 77A(1) and not Section 77A(3) or Section 77B(1) &(2).

c) The SCIT had erred when it held that the Accompanying Notes (*Nota Iringan*) and the "Reminder" (*Peringatan*) in the Form C, which remind taxpayers to compute taxes based on audited accounts, have imposed a legal requirement. It further erred in holding that the enactment of Section 77A(4) of the ITA was intended only to state clearly the pre-existing legal requirement to file tax returns based on audited accounts. The Accompany Notes and Reminder to Form C was merely best practices or a guides that had not been made mandatory by the ITA at the material time. Furthermore, a guideline and internal ruling by the IRB merely act as a guideline and are not legally binding.

d) Any requirement for the use of audited accounts in the preparation of tax returns, bearing criminal consequences, should be specified in the legislation, not under the *Nota Iringan* and the *Peringatan* of Form C.

e) The word "particulars" in Section 77A(3)(b) of the ITA does not refer to the Respondent's reminder in the Accompanying Notes (*Nota Iringan*) to Taxpayers but to the "details" required to be declared by the taxpayer when filing a tax return. Thus, the particulars that are required by the Director-General to be contained in a tax return pursuant to Section 77A(3)(b) of the ITA is a separate matter from the requirement that the tax return should be filed and computed based on audited accounts.

f) The IRB did not adduce any evidence on its exercise of discretion to impose penalty. Instead, explanations were only given through written and oral submissions from the bar table. The Court found that deficiencies in evidence from the witnesses cannot be rectified by counsel giving evidence from the bar table.

g) Further, the imposition of penalties by the IRB is discretionary, and such discretionary powers conferred on a public body such as the IRB are not unfettered. When such discretion is wrongly exercised or not explained, the Court has a duty to intervene.

The Court of Appeal's Decision

The Court of Appeal agreed with the Taxpayer's submissions and affirmed the High Court's decision, rendering the decision in favour of the Taxpayer.

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3. H SDN BHD V PENGARAH KASTAM NEGERI PAHANG & KETUA PENGARAH KASTAM, JABATAN KASTAM DIRAJA MALAYSIA (High Court)

This is a case that involves the excise duties under the Excise Act 1976. The High Court has recently quashed the Custom's decision to impose additional excise duties by uplifting the Open Market Excise Value ("**HPTE Value**") retrospectively.

Brief Facts

The Taxpayer invested RM360 million in plant and other infrastructure / facilities ("**Investment**"), expecting to sell 188,200 units of "V" brand cars in Malaysia between 2010 and 2020. These cars are subject to excise duties. To gain Customs' approval of the HPTE Value, the Taxpayer acceded to the Customs' request to include the amortisation rate of its investment (i.e., **Investment Amortisation rate**") into the calculation of HPTE Value based on the **planned volume** of V cars (i.e., 188,200). The Taxpayer paid excise duty based on the approved HPTE Value, which was also factored into the selling price of the vehicles.

However, much fewer cars were sold than planned. Customs subsequently took a different position and opined that the Investment Amortisation Rate (which ultimately affects the HPTE Value) ought to be calculated **based on the actual volume** of V cars sold. This increased the HPTE Value per V cars sold by the Taxpayer and

raised the excise duties payable per car. Consequently, the Taxpayer had to cover the excise duties at its own expense as there was no way to recover these expenses from the buyers who had already purchased the cars.

The Court's Decision

The High Court concluded that the Taxpayer did not underpay the excise duties. Although the detailed grounds of judgment are not available at this point of time, it would appear that the court accepted the following arguments from the Taxpayer regarding the determination of the HPTE Value:

(a) There are no provisions in the Excise Act 1976 which require taxpayers to include the Investment Amortisation Rate in the HPTE value.

b) The HPTE Value must only be determined once and with finality upon removal from the licensed warehouse.

c) The HPTE Value cannot fluctuate based on the sales performance of V cars.

d) Customs should not retrospectively uplift the HPTE Value based on an *ex-post facto* factor – the Actual Number of cars sold by the Taxpayer in a year.

e) The Custom's decision to impose additional excise duties payable by the Taxpayer would lead to commercial impossibility and manifest absurdity.

Additional Notes –
The Importance of this decision

This case is crucial to taxpayers for the following reasons:

a. This case provides clarity on the determination of the HPTE Value for excise duties. It is clear that, in the absence of any mandatory provisions in the Excise Act 1976, taxpayers are not obligated to include the Investment Amortisation Rate in the HPTE Value.

b. The court's decision underscores the principle that the HPTE Value should be determined once and with finality at the point of removal from the licensed premises / place of manufacture, rather than at any point thereafter. This prevents Customs from blowing hot and cold on the approved value / amount that taxpayers rely on for calculating and paying excise duties.

c. The court accepts that the HPTE Value should not be uplifted retrospectively based on the actual volume of the goods sold in a year. This would impose unexpected financial burdens on taxpayers, especially when they cannot determine the sale pricing of goods since the goods have not yet been sold at the time of calculating the excise duties payable to Customs.

The Custom's position would create a vicious cycle, where lower sales of goods may trigger an increase in the Investment Amortisation Rate and excise duties per car, causing elevated prices and a subsequent contributing to a further decline in sales. This vicious cycle will further result in commercial impossibility and manifest absurdity.

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4. MASS RAPID TRANSIT CORPORATION SDN BHD v KPHDN (High Court)

It may seem pedantic to state that income tax is a tax on income only: "***Income tax, if I may be pardoned for saying so, is a tax on income***"[1]. It is neither a tax on revenue, Government grants, nor capital injection for shares. This elementary principle, which was regarded as a truism by the House of Lords even 120 years ago, was applied by the Supreme Court in ***Lower Perak Cooperative Housing Society Bhd v KPHDN***[2]. Most recently, the High Court saw the need to reaffirm this again. Essentially, this appeal is the first decision to confirm that **capital receipt in return for shares is not an income**. It would seem that this case is the first reported case in Malaysia that elucidates this principle of law.

[1] ***The London County Council and others v The Attorney-General*** [1901] AC 26 per Lord Macnaghten
[2] ***Lower Perak Cooperative Housing Society Bhd v KPHDN*** [1994] 2 MLJ 713

Brief Facts

The Taxpayer is a public infrastructure developer who received capital injections from the Government to construct and manage a public infrastructure project. In consideration for the capital injections, the Taxpayer issued shares to the Government, thereby increases the Government's shareholding and equity stake in the Taxpayer. The monies received from the Government were recorded as equity in the Taxpayer's books, and the Taxpayer would not pay any income tax on these receipts. Due to the long gestation period of the project and large operating expenses ("**OPEX**") incurred, the Taxpayer incurred significant business losses. The Taxpayer set-off / deducted these losses against its aggregate income.

The IRB disallowed the deduction of OPEX by invoking Paragraph 3(1) of the Income Tax (Exemption) (No. 22) Order 2006 ("**Exemption Order**"). Paragraph 3(1) of the Exemption Order provides that deductions of expenditure incurred out of the income / grant under Paragraph 2(1)(a) would be disallowed. In this regard, the IRB contended that the capital injection by the Government into the Taxpayer in return for shares should be considered as an "income" or a "grant" under Paragraph 2(1)(a), and therefore the deduction should be disallowed.

The Issues at the SCIT and the High Court

a) The Taxpayer's appeal to the SCIT was dismissed. Consequently, the Taxpayer appealed to the High Court.

b) The predominant issue to be determined by the High Court was:

> "Did the capital injected by the Government into the Taxpayer, in return for shares, constitute both (a) an income and (b) a grant within the meaning of Paragraph 2(1)(a) of the Exemption Order?"

c) If both of these conditions are not met, Paragraph 3(1) of the Exemption Order cannot be invoked by the IRB and the Taxpayer's appeal should be allowed.

The High Court's Decision

Upon hearing both parties, the High Court decided in favour of the Taxpayer and held, amongst others, that: -

a) The ITA only imposes taxes on the income of the taxpayer. It does not impose tax on a capital receipt. This fundamental principle is reflected in Section 3 of the ITA. Further, a receipt is either a revenue or capital in nature, and it is not possible to be both[3].

b) As it has been agreed that the funds from the Government were capital injections recorded as equity in the Taxpayer's audited financial accounts, the capital injection cannot possibly be an income within the meaning of Paragraph 2(1)(a) of the Exemption Order. In this regard, the High Court referred to multiple foreign authorities which showed that capital injections in consideration of the issuance of shares are capital receipts and not income subject to tax.

c) The High Court reaffirmed the principle of law that parties / courts are bound by the Statement of Agreed Facts. The SCIT is not entitled to regard otherwise when parties have agreed that the funds were capital injections.

d) As such, when no tax is eligible, there is no necessity for the taxpayer to utilise the Exemption Order[4]. In this regard, the Exemption Order cannot be invoked by the IRB to disallow the Taxpayer's deduction of OPEX.

Additional Notes –
The Importance of this decision

a) This is a landmark decision strengthening the legal position by shedding light on the definition of "income".

b) The IRB's power to raise assessments and impose penalties are not unfettered and should not be exercised arbitrarily, at its own whims and fancies. The courts remain the gatekeeper of the legality of these assessments, ensuring that the IRB's power is exercised judiciously in accordance with established laws and principle.

c) The High Court's decision is a welcome addition to the income tax law jurisprudence, balancing the need of Government's revenue with safeguards for taxpayers against

[3] ***Mamor Sdn Bhd v Director-General of Inland Revenue*** *[1981] 1 MLJ 117*
[4] ***Ketua Pengarah Hasil Dalam Negeri v Perbadanan Kemajuan Ekonomi Negeri*** *Johor [2009] 4 MLJ 682*

arbitrary assessments. It aligns with the Supreme Court's decision in ***Gov't of Malaysia v Jasanusa Sdn Bhd***[5], which cautions against incorrect assessments that may be influenced by collection targets.

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5. P v KETUA PENGARAH HASIL DALAM NEGERI (SCIT)

This is a landmark decision on the transfer pricing regime in Malaysia. In this case, the SCIT had occasion to consider the application and effect of Section 140(A) of the Income Tax Act 1967 and the IRB's Transfer Pricing Guidelines 2012 in light of the wider international transfer pricing practice by other jurisdictions, as well as the international transfer pricing regime laid down by the Organisation for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines. Among others, the SCIT had to delve deep into technical considerations, such as the selection of comparables and circumstances under which the IRB has the power to substitute the Taxpayer's adopted price.

Brief Facts

The Taxpayer is engaged in investment holding, processing, and marketing of edible oil products, and manufacturing of steel drums. After conducting an audit, the IRB raised three income tax assessments amounting to approximately RM21 million, alleging that:

a) Reinvestment Allowance (RA): The Taxpayer is not entitled to claim RA in the categories of "expansion" and "diversification" for the capex incurred on certain manufacturing plants because the manufacturing plants produced new product that the Taxpayer never manufactured before. The manufacturing plants were also a "backwards integration project" producing raw materials for the Taxpayer.

b) Transfer Pricing (TP) (Year 2011): Notwithstanding that the Taxpayer's result is within interquartile range, the Taxpayer's result is below the median among the selected comparables and thus not within an arm's length range. Consequently, the IRB is justified in making adjustments to the Taxpayer's result.

c) Transfer Pricing (TP) (Year 2014): The Taxpayer's result is out of the interquartile range and thus not within an arm's length range. Consequently, the IRB is justified in making adjustments to the Taxpayer's result.

The SCIT's decision

On 15.12.2023, the Special Commissioners of Income Tax (SCIT) allowed the Taxpayer's appeals and discharged three income tax assessments raised by the Inland Revenue Board (IRB). The SCIT accepted the Taxpayer's submissions, holding that:

(a) The IRB cannot impose additional conditions on taxpayers to claim an allowance / incentive.

i. This decision on RA provides affirmation on recent decisions by the High Court (reported in [2022] 1 LNS 1226) and the Court of Appeal in Seiwa Podoyo (decided on 6.12.2023), statingthat the IRB cannot impose additional conditions in claiming RA beyond what is prescribed by Parliament in Schedule 7(A) of the Income Tax Act (ITA).

ii. Under Schedule 7(A) of the ITA, the only requirement is that the project must be a "qualifying project" under Paragraph 8(A). However, nowhere in Schedule 7(A) does it provide that a taxpayer can only claim RA if the project produces product that the taxpayer has produced before. Similarly, the IRB is not entitled to disallow an RA claim by imposing additional restriction to claim RA on a "backwards integration project".

b) No adjustment can be made under Section 140(A) of the ITA if the taxpayer's result is within the minimum and maximum range when there is no comparability defect in the selected comparables.

i. This decision upheld the principles in recent decisions by the SCIT and High Court in Sandakan Edible Oils (High Court reported in [2023] 1 LNS 616) where the courts will not countenance belated and unsubstantiated allegations of comparability defects to justify TP adjustments.

[5] ***Gov't of Malaysia v Jasanusa Sdn Bhd*** *[1995] 2 CLJ 70*

ii. In the absence of any comparability defect in the selected comparables, there is no requirement to narrow the arm's length range to the interquartile range.

iii. In short, the minimum to maximum range of a benchmarking analysis is the arm's length range.

iv. This decision places crucial emphasis on and upholds the principles laid down in the OECD TP Guidelines, particularly Paragraph 3.55 and 3.62, where the latter states "any point in the range satisfies arm's length principle".

Additional Notes

The full grounds of judgment from the SCIT are eagerly anticipated to provide further clarification on taxpayers' rights to claim an incentive/allowance, and necessary clarity and welcomed guidance in TP adjustments in light of the recent promulgation of the Income Tax (Transfer Pricing) Rules 2023, which seeks to bring about unprecedented changes to the TP landscape in Malaysia.

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6. AKAMAI TECHNOLOGIES MALAYSIA SDN BHD & ANOR v KPHDN (High Court) & AKAMAI TECHNOLOGIES INTERNATIONAL AG v KPHDN & ANOR (High Court)

Double Taxation Agreements (DTAs) have become increasingly important in regulating taxation matters when cross-border businesses are involved. DTAs safeguard taxpayers by preventing them from being taxed twice on the same transaction or income source, i.e., both in their country of residence and in another country in which they have business dealings.

Recently, two separate judges at the Kuala Lumpur High Court (KLHC) had granted leave to commence judicial review in two separate applications by taxpayers involving a DTA dispute. The dispute pertains to a recurring issue in DTA matters i.e., whether the definition of royalty in the Income Tax Act 1967 (ITA) or a DTA that should prevail in the event of a conflict. This issue arises because the Director General of Inland Revenue (DGIR) insists on applying the ITA, despite the primacy given by Parliament to DTAs in Section 132 of the ITA.

Brief Facts

A1 is a Malaysian company and a reseller of services belonging to A2, which is a non-resident company. A1 makes annual payments to A2 to market and resell A2's services in Malaysia (the Payments). As the Payments did not fall within the definition of "royalty" in the relevant DTA, withholding tax under Section 109 of the ITA was not deducted by A1 from Payments made to A2. As a matter of prudence, A2 applied to the DGIR for a ruling to confirm the situation (Ruling Application).

However, the DGIR decided to:

a) raise tax assessments by invoking Section 39(1)(f) of the ITA to disallow the deductions claimed by A1 for the Payments on the basis that taxes were not withheld; and,

b) reject A2's Ruling Application.

Both decisions by the DGIR were made on the basis that the Payments by A1 to A2 were royalties solely by reference to the definition of "royalty" in Section 2 of the ITA. Aggrieved, A1 and A2 commenced two separate judicial review applications heard by two separate High Court judges to challenge the decisions.

The Courts' Decision:

Despite strenuous objection by the DGIR, both KLHC judges, in their respective matters, decided to grant leave and stayed the assessments.

a) Judicial Review against the Tax Assessments[6]

The salient points from the first grounds of judgment are summarised as follows:

i. The DGIR's decision arises from an error of law amounting to a clear lack of jurisdiction. This is due to the DGIR's failure to recognise that the Payments made by A1 to A2 are not royalty within the meaning of the applicable DTA. There is, therefore, no basis for the DGIR to disallow the Payments for deduction pursuant to Section 39(1)(f) of the ITA.

[6] ***Akamai Technologies Malaysia Sdn Bhd & Anor v Ketua Pengarah Hasil Dalam Negeri*** *[2022] 1 LNS 2641*

ii. The DGIR has failed to abide by binding decisions of the superior courts despite being referred to them repeatedly. These decisions have confirmed that pursuant to Section 132 of the ITA, in the event of a conflict, the provisions of a double taxation agreement or a relief order should prevail over the ITA.

iii. The taxpayers have been consistent in their tax treatment and have disclosed this to the DGIR at an early stage (in 2014). However, the DGIR only issued the tax assessments 7 years later in 2021, without raising any allegations of fraud, wilful default, or negligence to justify the imposition of the assessments for time-barred years.

iv. The Court has the power to stay the tax assessments. In particular, there is no explicit ouster clause within the ITA which limits the Court's inherent powers to grant a stay. The Court also agreed that "there is a clear pattern of the IRB failing to refund or delaying in refunding taxes in general".

b) Judicial Review against the Decision on the Ruling Application[7]

The salient points from the grounds of judgment can be summarised as follows:

i. The DGIR and the IRB have not succeeded in showing that the application was frivolous. Examples of frivolous applications are those made out of time, filed by meddlesome busybodies with no interest in the dispute, or against non-justiciable matters. The applicant is clearly an "adversely affected" party by the tax authorities' decision to reject the Private Ruling Application.

ii. The DGIR argued that there was no "decision" to be challenged, as it has used the word "*berpandangan*" in opining that the Payments comes within the definition of "royalty". According to the DGIR, this was a mere "opinion" and not a "decision". The Court rejected this argument, holding that the assertive nature of the statement comes within the meaning of "decision" within the meaning of Order 53, Rule 2(4) of the Rules of Court 2012 (ROC).

iii. The Court agreed that there was no alternative remedy of an appeal to the Special Commissioners of Income Tax (SCIT) by A2, as the non-resident recipient of the Payments. This was because Section 109(H) of the ITA is only available for the payer of the Payments i.e., A1.

Additional Notes

The IRB had previously filed appeals to the Court of Appeal against the High Court's decisions above. However, these have since been withdrawn.

It must be noted, of course, that these decisions are only for leave to commence judicial review, and not the substantive application itself. However, in light of the unambiguous decision by the KLHC that "the Respondent's Decision arises from an error of law amounting to a clear lack of jurisdiction" and that the Payments "are clearly not royalty, and hence not subject to withholding tax", it would be interesting to observe what arguments, if any, the DGIR could raise to counter such findings at the substantive stage.

Furthermore, the High Court's decisions again confirm that judicial review remains available for taxpayers to challenge decisions by the Malaysian tax authorities, especially where such decisions appear to have been made in defiance of DTAs and case laws.

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7. IMPRESSIVE EDGE SDN BHD v KPHDN (High Court)

The DGIR's power to raise assessments / additional assessment under the ITA has been one of the most important provisions in tax law. In particular, Section 91(1) of the ITA has prescribed a 5-year limitation period for the DGIR to raise assessment / additional assessment for underpayment of taxes. Assessments made outside the limitation period are considered time-barred. The exception to the usual limitation period only applies where it appears to the DGIR that there has been any form of fraud or willful default, or negligence.

In this case, the High Court clarified, amongst others, that the burden of proof is on the DGIR to establish a positive act of negligence in order for a time-barred assessment to be raised. While the

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[7] ***Akamai Technologies International AG v Ketua Pengarah Hasil Dalam Negeri & Anor*** *[2022] 1 LNS 2261*

taxpayer's appeal was initially dismissed by the Special Commissioners of Income Tax ("SCIT") in the first instance, the taxpayer's appeal was subsequently allowed by the High Court on 18 October 2023.

Brief Facts

The Taxpayer is a company that manufactures high-quality engineering spare parts & products, which are typically used in the automobile, electrical, and oil & gas industries. For YAs 2006 to 2008, the taxpayer incurred capital expenditure in expanding its manufacturing business and had accordingly claimed for Reinvestment Allowance ("RA") for the following activities: -

(a) In YA 2006, the taxpayer relocated its manufacturing activities from its previous factory ("Previous Factory") to a larger factory ("New Factory"); and,
(b) From YAs 2006 to 2008, the taxpayer purchased new machinery & equipment such as computers, software, and tooling equipment ("Disputed Items").

Additionally, the taxpayer utilised the carried-forward RA from YAs 2006 to 2008 in YAs 2011 and 2012.

Upon an audit conducted in 2015, the DGIR disallowed the taxpayer's RA claim for the portion of the floor area of the New Factory equivalent to the floor area of the Previous Factory ("Factory Floor Area") and the RA claims for the Disputed Items vide the Notice of Non-Chargeability ("NONC") issued in 2016 (10 years after 2006). The DGIR had also issued additional assessments and had imposed penalties on the taxpayer for YAs 2010 to 2012.

The IRB's Position

The DGIR's decision to disallow the RA claims was based on the reason that the Previous Factory was no longer in use and that the Disputed Items are not directly involved in the Taxpayer's manufacturing process. In this regard, the DGIR contended that the limitation period to raise time-barred assessments under Section 91(1) could be lifted as the taxpayer had been negligent in inaccurately claiming RA and had supplied false information.

The Taxpayer's Position

a) The Taxpayer was not negligent in filing an incorrect return for claiming RA.

i. The exception to the usual limitation period only applies where it appears to the DGIR that there has been any form of fraud or willful default, or negligence. The time bar was attributable to the **DGIR's delay by only conducting audit and issuing assessments after 10 years**.

ii. Further, an error in a tax claim or filing an inaccurate tax return does not equate to negligence. It must be noted that the taxpayer has submitted its taxes based on professional advice, a principle affirmed by our Courts in *Seiwa-Podoyo* and *Infra Quest*.

iii. The assessments and penalties imposed for YAs 2011 & 2012 are also time-barred, as they arose from the DGIR's disallowance of the RA claimed by the taxpayer in YAs 2006 to 2008. Our Courts have held that the time-bar period should be calculated from the years where the capital allowance was disallowed, not the year in which it was utilised.

b) The DGIR relied on its internal ruling rather than Schedule 7(A) of the ITA in interpreting the RA provisions.

i. The wordings of Paragraphs 1 and 8, Schedule 7(A) of the ITA (provisions for RA claims) unambiguously state that the taxpayer is entitled to RA as long as it has incurred capital expenditure for a qualifying project. Qualifying project means: -

> "A project undertaken in … Expanding its existing business in respect of manufacturing of a product or any related product within the same industry …"

ii. Schedule 7(A) of the ITA does not confer power to the DGIR to restrict the meaning of "factory" to the size difference of new and old factory. The SCIT's decision based solely on whether the old factory was still in use is an erroneous consideration that is not stipulated in the law. The law states that RA claims shall be allowed as long as a company incurred expenditure on a factory and satisfies the definition of a qualifying project under Paragraph 8, Schedule 7(A) (i.e., expansion).

iii. The DGIR is also not entitled to disallow RA claims for the Disputed Items based on its

internal ruling not stipulated under the law, by alleging that the Disputed Items were located outside the production area and/or not directly involved in the manufacturing process. Our courts have ruled that the fact that certain RA disputed items are not located at the production area does not necessarily mean that they fall outside the ambit of Paragraphs 1, 8 and 9, Schedule 7(A) of the ITA. Therefore, the DGIR's decision is ultra vires, and its interpretation is akin to rewriting the ITA and usurping the function of legislature.

The Court's Decision

The High Court allowed the Taxpayer's appeal and quashed the DGIR's three assessments along with the SCIT's decision, holding that:

(a) The limitation period for tax assessments must be calculated from the year in which the capital expenditure was incurred and when RA was claimed, rather than the years in which RA was utilised. In this regard, the assessments for YAs 2011 and 2012, which arose from the disallowance of RA claimed in Yas 2006 to 2008, are also time-barred.

(b) Differing tax treatment and filing of alleged incorrect / inaccurate tax returns cannot *ipso facto* amount to negligence. Instead, **the IRB is required to prove** more than an inaccurate / incorrect return by establishing **a positive act of negligence in order to lift the limitation period** for issuing time-barred assessment.

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8. KPHDN v SAP MALAYSIA SDN BHD (High Court)

It is commonly understood that taxpayers who under-report their income and underpay their taxes can expect penalties to be imposed. Even so, the courts have indicated that the Director General of Inland Revenue (DGIR) must give reasons for exercising its discretion to impose penalties. These conventional wisdoms were affirmed back in 2022 by the Special Commissioners of Income Tax (SCIT), who unanimously allowed an appeal by a taxpayer who had been penalised by the IRB despite having overpaid taxes. Aggrieved, the DGIR appealed against the SCIT decision, but the appeal was dismissed. The High Court recently issued its grounds of decision.

Brief Facts

The taxpayer is the Malaysian entity of a multinational software company. The taxpayer filed its tax returns and paid taxes for the years of assessment (YAs) 2010 and 2011 based on its management accounts (Original Returns). When the Original Returns were filed, the taxpayer has already overpaid taxes through its monthly instalments based on estimated taxes payable. Some time later, the taxpayer filed in revised returns to reflect the profits shown in its finalised audited accounts. It transpired that it had significantly overreported its chargeable income and overpaid taxes of more than RM 1.4 million.

The Director General of Inland Revenue (DGIR) did not refund the overpaid taxes to the taxpayer but instead issued Form J (Assessments) on the taxpayer, imposing penalties of more than RM 1.5 million under Section 112(3) of the Income Tax Act 1967 ("ITA"). These penalties were calculated not based on any shortfall of taxes (of which there was none) but on the entire taxes payable for YAs 2010 and 2011 respectively, as if the Original Returns have never been filed and as if no taxes have ever been paid. When the Assessments were issued in 2017, the DGIR did not give any reasons why it had imposed penalties, or why time-barred assessments (pursuant to Section 91(1) of the ITA) should be raised. Aggrieved, the Taxpayer appealed to the SCIT, and the appeal was decided in the Taxpayer's favour. Dissatisfied, the DGIR appealed to the High Court against the SCIT's decision.

DGIR's position:

The DGIR's arguments in the High Court, in essence, are:

a) The earlier returns are treated as never having been filed (in breach of Subsection 77A (1) of the ITA) on the basis that the earlier returns were filed based on draft financial statements and not final audited accounts.

b) The Taxpayer had been negligent in connection with the submission of the earlier income tax returns.

c) The penalties are validly imposed under Section 112(3) of the ITA as the earlier income tax returns did not qualify as returns within the meaning of Section 77A of the ITA.

Taxpayer's position:

(a) The Assessments are time-barred pursuant to Section 91(1) of the ITA. As the Assessments were issued more than 5 years after the YAs in dispute, the DGIR must prove that it comes within Section 91(3) of the ITA. This requires the DGIR to show that it was necessary for the assessment to be made **to make good any loss of tax** attributable to the taxpayer's **fraud, wilful default, or negligence**. Here, there has never been any loss of tax. It was common ground between the parties at all times that the taxpayer has overreported its income and overpaid its taxes for both YAs in dispute.

(b) There was **no legal requirement to submit tax returns based on audited accounts until after YA 2014**. The legal requirement to file tax returns based on audited accounts was **only inserted via Section 77A (4) of the ITA**, which came into effect on YA 2014. This requirement did not exist in YAs 2010 and 2011. Nevertheless, the DGIR treated the Original Returns as a nullity as they were filed based on management accounts. Amongst others, the DGIR argued that it has issued guidelines on how to prepare tax returns, which clearly required taxpayers to use audited accounts. In reply, the taxpayer argued that these guidelines have no force of law; the DGIR cannot use them to impose an obligation that Parliament has not prescribed.

(c) The DGIR has failed to justify the penalties imposed. In the circumstances, the DGIR is obliged to, but has **failed to, give any reasons why penalty ought to be imposed not on the underpaid taxes for the YAs in dispute (of which there were none) but on the entire taxes payable for both YAs 2010 and 2011**. The DGIR has also failed to explain why there was a need to issue the time-barred Assessments **despite there being no "loss of tax"**.

The Courts' Decision:

a) In May 2022, the SCIT allowed the taxpayer's appeal and set aside the Assessments raised, holding that the DGIR had no legal or factual basis to impose the penalty pursuant to Section 112(3) of the ITA.

b) On 3 April 2023, the High Court dismissed the DGIR's appeal and issued written grounds on 11 September 2023. The High Court judges agreed with the Taxpayer's arguments, holding that:

i. The DGIR can only rely on subsection 91(3) of the ITA for one purpose, that is, to make good **any loss of tax** attributable to the fraud, wilful default, or negligence in question. In the instant case, the SCIT found that the element was not satisfied and in fact found that there was overpayment of tax. Overpayment of tax means that the government has suffered no loss of tax but a windfall not legally due to it. The reliance on Subsection 91(3) of the ITA is misconceived, and the SCIT was absolutely correct in its decision holding that the impugned assessments were therefore statute-barred.

ii. **The law in force at the time did not require the Taxpayer to file its tax returns based on its audited accounts**. The requirement that tax returns must be filed based on the Taxpayer's audited accounts (subsection 77A (4) of the ITA) was only introduced subsequently by the Finance Act 2014 and does not apply to the Taxpayer's tax returns for YA 2010 and YA 2011. The **DGIR's guidelines on how to prepare tax returns do not have the force of law** and cannot be relied on by the DGIR to impose an obligation that Parliament has not prescribed.

iii. The **burden is on the DGIR**, under Section 91(3), **to show that the appellant had been 'negligent'** in connection with or in relation to tax for a certain year of assessment. As the Taxpayer filed its returns as required under the law in force at the time, the Taxpayer was not negligent.

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9. KPHDN v CASH BAND (M) BERHAD (High Court)

This matter was initiated in the SCIT and went on appeal to the High Court. Both courts found in favour of the Taxpayer and confirmed that income tax was not payable by a landowner who received a share of the gross revenue generated from a development, under a joint venture agreement (JVA) with a developer. We have since received the written grounds of judgment.

The Court's Decision:

The Court agreed with the Taxpayer's submissions and dismissed the IRB's appeal. The key new propositions from the High Court judgment are:

a) Directors' expertise and skills cannot be imposed on a Taxpayer Company

i. As is invariably the case, the Revenue contended that one of the Taxpayer's directors has experience and skills in development activities and projects with other companies. This was said to be indicative of an intention to trade on the part of the Taxpayer company. The High Court categorically rejected this contention, holding that:

> "The personal expertise and special skills of an ordinary company director, if at all, cannot, by any legal imagination, be imposed on the company."

ii. The firm rejection of the notion that a director's personal skills and experience can be transposed upon a taxpayer company to justify an intention to trade is consistent with company law and the existence of the corporate veil. Failure by the Revenue to adhere to this decision in issuing future assessments could constitute a basis for judicial review.

b) Mere execution of a JVA does not constitute trading

i. The execution of a JVA to develop lands originally acquired as capital assets did not constitute trading. The Revenue's own Public Ruling No. 1/2009: Property Development recognises that a landowner who enters into a joint venture project is not undertaking a business if he does not take an active part in the development activities [Paragraph 15.3(A)]. In this case, the terms of the JVA showed that the entire development was to be carried out by the joint venture partner, with the Taxpayer being merely a passive landowner.

ii. This is believed to be one of the first decisions concerning the tax treatment of gains derived by a landowner under a JVA, which is based on a percentage of the gross revenue rather than a fixed price. The High Court's decision has confirmed that this alone would not be sufficient to warrant a conclusion of trade.

c) Steps taken to ascertain the maximum value of land does not constitute a change of intention

i. The evidence showed that before entering the JVA, the directors of the company had contemplated several alternatives, including developing the land themselves.

ii. The Court rejected the Revenue's argument that exploring various options constituted a change of intention from investment to trading. It is perfectly legitimate for the directors to explore various options to ascertain the maximum value of the land before settling on a JVA; indeed, it is the duty of the board of directors to do this.

Additional Note:

After the High Court rendered its decision, the IRB had filed an appeal against the High Court's decision to the Court of Appeal. However, this appeal by the IRB was subsequently withdrawn from the Court of Appeal. With this, the High Court's decision is final.

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10. SUNRISE HOME GOODS (M) SDN BHD v KETUA PENGARAH KASTAM & ANOR (High Court)

Brief Facts

Sunrise Home Goods (M) Sdn Bhd ("**Taxpayer**") manufactures kitchen products solely for export purposes. The Taxpayer is a licensed warehouse ("**LW**") and a licensed manufacturing warehouse ("**LMW**") regulated by Section 65 and Section 65(A) of the Customs Act respectively. To manufacture the exported kitchen products, the Taxpayer imported steel from China, which was subject to anti-dumping duty pursuant to the Customs (Anti-Dumping Duties) Order 2018. The Taxpayer did not pay anti-dumping duty on the imported steel used solely for the manufacture of the kitchen products, as the anti-dumping duty was exempted during import due to the Taxpayer being a LW and LMW licensee. The Customs Appeal Tribunal ("**Tribunal**") upheld Custom's decision to impose anti-dumping duties on the steel imported by the Taxpayer. Aggrieved by the decision of the Tribunal, the Taxpayer appealed to the High Court.

Customs' Position

The Customs took the position that anti-dumping duty is not included within the scope of the customs duty exemption granted to LW and LMW under the Customs Duties (Exemption) Order 2017 ("**Exemption Order**"). The customs duty exemption is only limited to import and export duties, as the Exemption Order was enacted in response to the Customs Duties Order 2017 ("**Customs Duties Order**"), which imposed import and export duties only.

Taxpayer's Position

Conversely, the Taxpayer argued that customs duty exemption under the Exemption Order includes anti-dumping duty for the following reasons:

a) The Exemption Order was enacted by the Minister of Finance ("**Minister**") in exercising its power under Section 14(1) of the Customs Act, which enables the Minister to grant full or partial exemptions.

b) Pursuant to Section21(1) of the Interpretation Acts 1948 and 1967, the terms and expressions used in subsidiary legislation have the same meaning as the written law under which the subsidiary legislation was made.

c) Therefore, the term "customs duty" used in the Exemption Order shall have the same meaning as defined in the Customs Act.

d) Section 2(1) of the Customs Act defines "customs duty" to include "*any import duty, export duty, surtax, surcharge or cess… any countervailing duty or* ***anti-dumping duty imposed under the Countervailing and Anti-Dumping Duties Act 1993****, any safeguard duty imposed…*".

The Court's Decision

The High Court agreed with the Taxpayer and allowed the Taxpayer's appeal. Customs is currently appealing against the High Court's decision to the Court of Appeal.

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