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SECTION 109 INCOME TAX ACT 1967 & DOUBLE TAXATION AGREEMENT BETWEEN MALAYSIA & SINGAPORE

RFSSB
V.
DIRECTOR GENERAL OF INLAND REVENUE
MOF.PKCP.700-7/1/2526

The Taxpayer entered into a Distribution Agreement with DSSPL (a resident of Singapore) on 29.9.2017. Pursuant to the terms therein, the Taxpayer was appointed by DSSPL as its non-exclusive distributor of DS Offerings and Support Service in Malaysia. Based on internal information received, Director General of Inland Revenue ("DGIR") discovered that the Taxpayer had made payment to DSSPL amounting to RM278,283.38 on 1.9.2020 for use of computer software. Subsequently, on 13.4.2022, the DGIR issued a letter of demand to the Taxpayer informing that it was required to pay withholding tax including an increase of 10% under Section 109(2) of Income Tax Act 1967 ("ITA 1967") in the amount of RM30,611.17. The Taxpayer made the payment of withholding tax and the additional tax in protest and subsequently filed Form Q to appeal against the withholding tax and additional tax imposed.

The Taxpayer contended that the Letter of Demand was issued by the DGIR arbitrarily without reviewing any supporting documents, particularly the Distribution Agreement. The DGIR only relied on internal information received which lacked sufficient particulars to justify the imposition of withholding tax. The DGIR also failed to give proper effect to the Double Taxation Agreement ("DTA"), as it applied the definition of royalty under Section 2 ITA 1967 instead of the definition under Article 12(3) of the DTA when determining whether Distribution Fees paid to DSSPL were royalties. The Taxpayer argued that Section 132(1) ITA 1967 provides that DTA shall, have effect and prevail over the ITA. The Taxpayer further submitted that the distribution fees paid to DSSPL were not royalties within the definition of Article 12(3) of the DTA. The distribution fees paid were for the right to market and distribute DS Offerings and Support Services, not for exploiting any rights in DS Offerings' copyrights.

In response, the DGIR argued that a Letter of Demand is not a final assessment but forms part of the administrative and audit process of tax enforcement. At that stage, the DGIR is entitled to rely on available information, including internal data sources, to initiate inquiries. The issue before the Court is not whether the Letter of Demand was procedurally perfect, but whether the underlying tax liability exists in law. The characterization of software payments as "royalties" under Section 2(1) ITA 1967 is consistent with the United Nations Model Double Taxation Convention (UN Model). Further, when a DTA does not independently define all terms, domestic law comes into force to fill in the gaps. Though the DTA explicitly includes the term "software" in its definition of royalties, but it also includes mentions of "copyrights of literary works," and software falls under this category. Under Section 3 of the Copyright Act 1987, a "literary work" specifically includes computer programs. The DGIR also submitted that the Taxpayer exploited intellectual property under the license granted by DSSPL. The assertion that the Taxpayer only has "marketing/distribution" rights contradicts the contract's term granting software operation/installation/copy and trademark use to the Taxpayer. The "FOC" label on demo license is economically immaterial. The value of those rights is embedded in the Distribution Fees. Despite being described as distribution fees, the payments arise from rights granted over IP and are linked to use of software and trademarks. Hence, the said payments are subject to withholding tax.

On 22.5.2026, the Special Commissioners of Income Tax ("SCIT") dismissed the Taxpayer's appeal on the withholding tax, subject to further recalculation of the withholding tax according to the DTA by the DGIR. The SCIT further decided that the Taxpayer's appeal on the increased sum of 10% under Section 109(2) ITA was allowed.

Editorial Note

- *Both the Taxpayer and the DGIR has the right to file an appeal against the decision by the SCIT within 21 days from the date of the decision.*