

**ARTICLE 11 MALAYSIAN – INDONESIAN
DOUBLE TAXATION AGREEMENT**



PPMEP

V.

**DIRECTOR GENERAL OF INLAND REVENUE
MOF.PKCP.700-7/1/2099-2102**

 **SPECIAL COMMISSIONERS OF INCOME TAX**

 **PUAN FAJRUL SHIHAR BINTI ABU SAMAH**

 **27TH FEBRUARY 2025**

The Taxpayer is a company incorporated in Indonesia and engaged in exploration and production of petroleum. The Taxpayer entered into several agreements with PTTEP and PCSB for the exploration and production of petroleum in Sabah and Sarawak offshore.

Pursuant to the Production Sharing Contracts (PSCs), all parties are required to contribute funds to the PSCs Operator in order to facilitate the operation of the PSCs. Subsequently, the funds shall be transferred to the Escrow Account and be kept by the PSCs Operator. Where such deposits generated interest, these will be allocated to the respective partners based on a pro-rata basis. In view of Section 4B Income Tax Act 1967 (ITA 1967), Paragraph 2 of Article 11 of the Malaysian – Indonesian Double Taxation Agreement (DTA) and the amending Protocol to Treaty between Indonesia and Malaysia, the Taxpayer brought the interest income to tax at the rate of 10% for the relevant Year of Assessments (YAs). The Director General of Inland Revenue (DGIR), on the other hand subjected the Taxpayer's interest income to tax at a rate of 25% for YA 2015 and 24% for YAs 2016 to 2018 according to Paragraph 2 Schedule 1 ITA 1967. The assessment raised by the DGIR for YA 2015 is also time-barred.

The Taxpayer contended that it was not negligent in filing of its tax return (Form C) for YA 2015 as it has filed its Form C on time under Section 77A(1) ITA 1967, and although the audited financial statement was unsigned during the time of filing, the information provided was still accurate and complete as the Taxpayer's Form C was filed based on the parent's company consolidated audited accounts which were signed and audited. The Taxpayer also contended that it was not negligent as it sought an advice from professional tax agent and had given full cooperation to the DGIR during the tax audit. On the issue of tax rate, the Taxpayer argued that as the interest income arising from the Escrow Account is a passive income, Articles 11(1) and (2) DTA shall apply, and the relevant tax rate is 10%.

In response, the DGIR asserted that the Taxpayer was negligent in relation to its tax treatment for YA 2015 as the Taxpayer failed to prepare its Form C based on the audited account as envisaged under Section 77A(4) ITA 1967 (prior amendment). The purpose and intent of Section 77A(4) ITA 1967 is to require a company to submit its Form C based on audited account. It is also a mandatory requirement for the Taxpayer to comply with all of the conditions stipulated under Section 77A ITA 1967. Further, it was also admitted during trial by the Taxpayer that there was no audited financial statement available for YA 2015 when the Form C was filed. As such, the Taxpayer's act in filing its Form C based on the draft audited financial statements is tantamount to an act of negligence.

On the issue of interest income, the DGIR has referred to Paragraph 2(b) Article 5 DTA in determining the Taxpayer's permanent establishment. Based on the facts, the Taxpayer is a Non-Resident company and has a permanent establishment in Malaysia by having a local Malaysian branch. As the income received by the Taxpayer was interest received from the Joint Venture Operating Account (JVA), the DGIR firstly referred to Paragraph 7 Article 11 DTA which states the exception to Paragraphs 1, 2 and 3 Article 11 DTA, where it states that Paragraphs 1, 2 and 3 Article 11 DTA shall not apply "if the beneficial owner of the interest, being a Resident of a Contracting State, carries on business in the other Contracting State in which the interest arises, through a permanent establishment situated therein and the debt-claim in respect of which the interest is paid is effectively

connected with such permanent establishment”.

Therefore, Article 7 DTA shall apply as the profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other State through a permanent establishment situated therein. In accordance with that, the DGIR asserted that the determination of the Taxpayer’s tax rate ought to be based on Section 6(1)(a) ITA 1967, specifically Part I Schedule 1 ITA 1967. The DGIR was of the view that the interest income derived from the JVA is effectively connected to the Taxpayer’s business as the interest income was used by the Taxpayer to finance the operation of its business. As the Taxpayer does not fall within the ambit of Paragraph 2A Schedule 1 ITA 1967, the applicable rates, 25% and 24% respectively as mentioned under Paragraph 2(1)(a) Schedule 1 ITA 1967 are therefore applicable.

The Special Commissioners of Income Tax on 27.2.2025 held that the Taxpayer failed to discharge its burden of proof under Paragraph 13 Schedule 5 ITA 1967 and that the DGIR has the legal and factual basis to impose penalties under Section 112(3) and Section 113(2) ITA 1967 against the Taxpayer.

Editorial Note

- *The Taxpayer has the right to appeal to the High Court within 21 days from the date of the decision.*