FEDERAL COURT RULED THAT NO CONFLICTS BETWEEN DOUBLE TAXATION AGREEMENT AND THE INCOME TAX ACT 1967

IBMMSB v. DGIR

Federal Court, Putrajaya

June 29, 2020

Legal Department, IRBM

JUDGES

Y.A. Puan Sri Dato' Zaleha Yusof
Y.A. Dato' Zabariah Mohd Yusof
Y.A. Datuk Hasnah Dato' Mohammed Hashim

REVENUE COUNSEL

Dr. Hazlina Hussain
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QUESTIONS TO BE DETERMINED BY THE FEDERAL COURT

1. Whether an Advance Ruling issued under Section 138B of the Income Tax Act 1967 ("ITA") is a decision which could adversely affect the Appellant within the meaning of Order 53 Rule 2(4) of the Rules of Court 2012 ("ROC"); and

2. Whether the definition of "royalty" under a Double Taxation Agreement shall prevail over the definition of "royalty" under Section 2(1) of the ITA.

BRIEF FACTS OF THE CASE

1. IBMMSB (the Appellant) made an application for an Advance Ruling to seek the DGIR's advice or interpretation on the proposed arrangement arrangement whether the payment which would be made by the Appellant, IBMMSB to IBMIPDL (a non-resident) under the proposed software distribution agreement is considered as 'royalty' and subject to withholding tax. For that purpose, the Appellant had submitted the respective documents, which includes the draft copy of the software distribution agreement between the Appellant and IBMIPDL.

2. The DGIR issued the Advance Ruling dated 7.06.2016.

3. IBMMSB filed a Judicial Review ("JR") application in the High Court to quash the Advance Ruling dated 7.06.2016 issued by the DGIR.

4. On 27.3.2018 the learned High Court Judge decided to allow IBMMSB, the Applicant's Application for JR.

5. The DGIR had appealed to the Court of Appeal against the learned High Court Judge's decision and the Court of Appeal on 19.2.2019 had unanimously decided for the DGIR.

6. Subsequently, on 29.10.2019, the Appellant obtained leave from the Federal Court, and the questions to be determined by Federal Court are as above.

THE APPELLANT'S SUBMISSION

1. The Advance Ruling is final and binding pursuant to Paragraph 16(1) of the Income Tax (Advance Ruling) Rules 2008 P.U.(A) 41/2008 ("Rules"). Paragraph 16(1) of the Rules provides that "an advance ruling issued to any person for the purpose of any arrangement shall be final and no appeal shall be lodged by any person against any advance ruling".

2. The Rules did not provide the Appellant any recourse or alternative remedy. Thus, the only remedy available to them is by way of judicial review.

3. As the Advance Ruling is final and binding, there is no provisions in the ITA to lodge appeal to the DGIR against the said Advance Ruling.

4. Therefore, the Advance Ruling issued by the DGIR adversely affected the Appellant and thus amenable to Judicial Review.

5. Further, section 68 of ITA provides that assessment is not the only decision that the DGIR made.

6. As for the second issue, section 132(1) of ITA clearly provides that the provision in the DTA shall prevail in the event that there is conflict between the DTA and the ITA. The issue is purely the question of interpretation of law and it is settled that the definition of royalty that found in the DTA takes precedent over the ITA. The case of ***Damco Logistic Malaysia Sdn Bhd v KPHDN*** and ***KPHDN v Thomson Reuters Global Resources Sdn Bhd*** were referred to support the Appellant's contention.

THE REVENUE'S SUBMISSION

1. The Advance Ruling issued by the DGIR did not "adversely affect" the Appellant within Order 53 Rule 2(4) of the ROC. The Appellant had failed to satisfy the *locus standi* condition under Order 53 Rule 2(4) of the ROC.

2. The Advance Ruling is only a view/interpretation by the DGIR based on the factual background of the application made by the taxpayer.

3. The Advance Ruling represents the DGIR's view/stand on the tax treatment for any proposed/future transaction sought by a taxpayer, as provided in section 138B (1) of ITA.

4. The Advance Ruling is final and binding pursuant to Paragraph 16(1) of the Rules as both the taxpayer and the DGIR must comply with the rulings. It does not mean that upon issuance of the Advance Ruling, any ruling which is not favourable to the taxpayer tantamount to a decision that adversely affect the taxpayer.

5. Paragraph 15(2) of the Rules also provides that if the taxpayer did not follow the Advance Ruling, they must disclose that in the return form for the year of assessment applicable under the Advance Ruling. Paragraph 15(2) of the Rules provides that –

"15(2) For the purpose of subrule (1), the person to whom the Advance Ruling applies shall disclose in the return –

(a) the issuance of the Advance Ruling;

(b) whether or not he has relied on the Advance Ruling in preparing and providing the return; and

(c) any material change to the arrangement to which in the advance ruling applies".

Thus, the Advance Ruling is binding pursuant to Section 138B (4) of ITA.

6. The Advance Ruling issued by the DGIR may or may not be favourable to a taxpayer. An unfavourable Advance Ruling does not prevent the Appellant from proceeding with the proposed arrangement.

7. The case of ***KPHDN v. Mudah.my Sdn Bhd*** and ***Members of the Commission of Enquiry on the Video Clip Recording of Images of a Person Purported to be an Advocate and Solicitor on Telephone*** were referred to support the Respondent's contention.

8. On the second issue, the Respondent submits that the ITA is the charging law on tax which provides for mechanism to collect tax by way of withholding tax on royalty, and the DTA is a provision for relief from double taxation. Article 13 on Royalty under the DTA between Malaysia and the Netherlands is applicable to determine whether the Appellant is eligible for relief.

9. The definition of "Royalty" under the DTA is in line with the definition given under the ITA. Thus, there is no issue of conflict between the DTA and the ITA. The payment made to the Netherlands is "royalty" under the DTA instead of "business income" as decided by the learned High Court Judge. Therefore, the learned High Judge had misconstrued Article 8/Business Income Article of the DTA.

10. There are facts in the draft Software Distribution Agreement which support the Revenue's contention that the payment of distribution fee relates to payment for the use of the right of computer program.

11. There are no facts established that the payment for distribution fee received by the non-resident is a business profits.

DECISION OF COURT

The Federal Court have considered submission of both parties and unanimously held on Question (1), the court are of the considered view that the Advance Ruling is not a decision under Order 53 Rule 2(4) of the Rules of Court 2012, which is amenable to Judicial Review. As the Question (2), the court have compared the two provisions and held that there were no conflicts between the DTA and the ITA.

Based on the above, the Federal Court dismissed the Appellant's appeal with cost of RM30,000.00.