

TECHNICAL

Direct Taxation

TAX CASE UPDATE

Whether the Director General of Inland Revenue (DGIR) is correct in disallowing “handling and repacking” charges paid by a Malaysian company to a non-resident company under section 39(1)(j) of the ITA. **[Statutory Ref. Sections 4A(ii), 15A and 109(b) of Income Tax Act 1967 (ITA)]**

[Ketua Pengarah Hasil Dalam Negeri v Teraju Sinar Sdn Bhd \(2014\) \(Court of Appeal\) \(Civil Appeal No: W-01-200-2010\)](#)

Date of Judgment: 21 April 2014

Facts:

The Respondent (Teraju) made payments to a Singaporean company (Union Concept Manufacturing Pte Ltd.) for services, described as “handling and repacking” services provided by the latter in Singapore. The services were to dismantle imported electrical equipment, the component parts of which were then marked, wrapped with other units and exported to Teraju in Malaysia as completely knocked down, or semi-knocked down equipment. The charges contained 2 major expenses – (1) on the cost of electrical item and its accessories, and (2) on the documentation for Cargo Import Declaration.

The DGIR raised additional assessments on Teraju for the years of assessment 1998, 1999, 2000 and 2002 in the year 2006 after disallowing deductions under section 39(1)(j) of the ITA for the above payments, on the basis that Teraju had failed to deduct withholding tax (WHT) under section 109B of the ITA from the payments to the non-resident (Singaporean) company.

Teraju appealed to the **Special Commissioners of Income Tax (SCIT)** against the additional assessments. The SCIT held that the DGIR was right in disallowing the “handling and repacking” charges, but found there was no basis for fees for Custom Export Declaration to be subjected to WHT.

Both Teraju and the DGIR filed appeals to the High Court against the SCIT’s decision. The **High Court** reversed the decision of the SCIT in respect of the “handling and repacking” charges, holding that the SCIT had erred in disallowing such charges, but upheld the exclusion of the Custom Export Declaration fees from WHT. The DGIR then appealed to the Court of Appeal (referred hereinafter as “the Court”)

Issue:

In its judgment, the Court addressed issues related to the following:

- i. WHT not deducted and paid over to DGIR;
- ii. Sections 4A and 15A;
- iii. Double Taxation Agreement

Decision:

The Court allowed the appeal of the DGIR, set aside the order of the High Court and reinstated the Deciding Order of the SCIT in respect of the disallowing of payments for “handling and repacking” charges, and dismissed the appeal in respect of the SCIT Order regarding Customs Declaration Fees.

The following are some of the main points of discussion in the Judgment:

(i) Role of an Appellate Court in a Tax Appeal

This is discussed at length in the Judgment. After citing extensively from judgments of precedent cases, the Court states its own view that “*there is no room for superficial dismissal of an appeal upon a question of fact simply upon pasting that label thereon*” and “*an appellate court ought to be slow to disturb a finding of fact by that Court or tribunal.*” However, where injustice is caused when that Court or Tribunal –

- i. is wrong in law or principle;
- ii. has so misappreciated the evidence that its finding is such that no person acting judicially or properly instructed could have come to the determination under appeal; or
- iii. has made a finding of fact wholly unsupported by facts or evidence or without sufficient evidence;

then the appellate court must correct the injustice.

On the other hand, where there is evidence or facts to support a finding, then it ought not to be disturbed even if another finding is also possible and even if the appellate court might prefer the alternative.

(ii) WHT not deducted and paid over to DGIR

The fact that no WHT were deducted and paid to the DGIR is not disputed by both appellant and respondent. Neither the High Court nor the SCIT erred on this. If WHT ought to have been deducted and paid to the DGIR by Teraju, then the appeal by the DGIR should be allowed since the requirement for WHT to be deducted from special classes of income derived from Malaysia is provided under section 109B of the ITA.

(iii) Sections 4A and 15A

Section 4A provides for 3 categories of special classes of income to be chargeable to tax in Malaysia if it is derived from Malaysia. The DGIR had relied on section 4A(ii) and therefore the germane question is whether the income is derived from Malaysia when payment is made by a resident company in Malaysia (Teraju) to a Singaporean company (non-resident in Malaysia) for services which were performed wholly in Singapore.

Section 15A is the “derivation” section for special classes of income and is a “deeming provision.” If it is wide enough then the fact that the service is wholly performed in Singapore may be irrelevant.

The SCIT had held that reading sections 4A(ii), 15A and 109B together, the “handling and repacking” charges fell within the ambit of section 4A(ii). The Court could find no reason to conclude that the SCIT did not consider the facts and evidence adduced before it. With all of the evidence before the SCIT, and the parties having had the opportunity to address the matter, the SCIT was entitled to make a finding on the evidence before it in order to come to a decision.

In the circumstances, the Court held that the High Court had erred in disturbing the finding of the SCIT that service provided fell within the provisions of section 4A(ii) and therefore section 15A(b).

The Court was also of the view that the either or both of the conditions stated in sections 15A(ii) and 15A(iii) describe Teraju and the payments it made.

Further, the Court rejected the submission that the amendment to section 15A effective 21 September 2002, showed Parliament had intended the deeming provision in section 15A to apply to services performed in Malaysia. It only applied after 21 September 2002 and not the assessment years in this case. The fact the amendment was made speaks more of Parliament changing the law rather than making a correction to reflect an intention existing previously but wrongly legislated.

(iv) The Double Taxation Agreement (DTA)

The ITA is the charging law and not the DTA, which determines availability of relief from tax (*LHDN v Alam Maritim (M) Sdn. Bhd.* (Federal Court 01(f)-23-09/2012(W)) (please refer to our [e-CTIM Tech 152/2013](#)). The duty of the payer to deduct withholding tax from payments which is deemed to be income derived from Malaysia if they come within the provisions of section 15A, is a responsibility which is entirely distinct or separate from the liability of the recipient of the payments (Union Concept) under section 4A(ii), notwithstanding the provisions of section 4. It is then for Union Concept to avail itself of the relief under the DTA.

There being no claim for relief by Union Concept, the issue whether Union Concept is relieved of liability does not arise. The Court held that Teraju's liability from its failure to act under section 109B, attracted the operation of section 39(1)(j) and that it is not a matter involving the operation of the DTA.

(v) DGIR's appeal on Customs Declaration Fees

On the submission that the SCIT and the High Court erred in law to hold that such fees should be allowed as a deduction, the Court referred to Revenue's submission that

"...as it was not an issue appealed by the taxpayer and no facts proved by SCIT that the expenses were wholly and exclusively incurred in the production of the income of the taxpayer under section 33 of the ITA, the Revenue's appeal on this issue should be allowed."

The Court went on to state that "(it) is not for the SCIT to prove anything. Resort to the Courts should not be wasted in this manner."

Note

In the taxpayer's first appeal to the SCIT, the tribunal had decided that "handling and repacking" charges fell within the ambit of section 4A(ii). In so deciding, the SCIT had accepted the authority of the document cited by Revenue to rebut the argument that the section 4A(ii) covers only payments for technical services. The document cited was Director-General Circular No. 1 of 1984 (DG's Circular) which explains the amendment of Act 293. In the circular, it was stated that

" The scope of the above provision covers both technical and non-technical assistance or services in connection with scientific, industrial or commercial undertaking, venture, project or scheme. While technical management envisages the passing over or utilization of expert or specialised knowledge, skills or expertise, it should be noted that the scope of the above provision is now wider and can in fact cover most forms of payments made for management or administrative services in connection with any industrial or commercial undertaking, venture, project or scheme."

The SCIT also mentioned that the DG's Circular was recognized in the case of AIA CL v KPHDN (2002) MSTC 3438 and thus it is clearly stated that the scope of section 4A(ii) covers both technical and non-technical services which was also confirmed in the decision of Esso Production Malaysia v DGIR (2003) MSTC 4016.

In reinstating the Deciding Order of the SCIT, the Court of Appeal appears to have given affirmation to the stand long held by Revenue that the scope of section 4A is wide enough to cover payments for both technical and non-technical services including management or administrative services in connection with any industrial or commercial undertaking, venture, project or scheme (as stated in the DG's Circular).

Members interested may read the full [Grounds of Judgment](#) from the official website of the Office of the Chief Registrar, Federal Court of Malaysia

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