
TECHNICAL

Direct Taxation**TAX CASE UPDATE**

Election made by a Labuan company under Section 3A of the Labuan Business Activity Tax Act 1990 (LABATA) and exemption of dividends received by that offshore company.

Positive Vision Labuan Limited v Ketua Pengarah Hasil Dalam Negeri (KPHDN)

Civil appeal; No:01(f)-11-03/2015(W)

GA Investment Limited v KPHDN

Civil Appeal No:01(f)-12-03/2015(W)

Avenues Zone Inc. v KPHDN

(Civil Appeal No:01(f)-13-03/2015(W))

Federal Court of Malaysia

Date of Judgment: 20 February 2017 ([Majority Judgment](#) & [Minority Judgment](#))

Facts and Issues:

This is an appeal against the decision of the Court of Appeal which had affirmed the decision of the High Court. The appeal to the Court of Appeal was reported in our [e-CTIM TECH-DT 61/2014](#). Please read the report for the facts of the case. The following is a brief recapitulation.

The appellants are offshore companies incorporated under the Offshore Companies Act 1990. They had made irrevocable elections under S3A of the Labuan Business Activity Tax Act 1990 (LABATA), to be taxed under the Income Tax Act 1967 (ITA). Under the Income Tax (Exemption) (No. 22) Order 2007 (“the Exemption Order”), dividends received by an offshore company are exempt from income tax effective from the year of assessment (YA) 2007. Each of the appellants received dividend income in the YA 2011. Each of them was issued with a Notice of assessment dated 2.8.2012 for the following tax payable:

| Name | Tax payable (RM) |
|--------------------------------|------------------|
| Positive Vision Labuan Limited | 36,754,986.00 |
| Avenues Zone Inc. | 24,650,000.00 |
| GA Investment Limited | 20,361,839.25 |

The appellants had been informed in a letter from the respondent dated 20.6.2012, that income tax exemption under the Exemption Order was no longer available to a Labuan company which has made an election to be taxed under the ITA w.e.f 12.2.2010, pursuant to a decision by the Ministry of Finance (MOF). Being aggrieved by the decision of the respondent, the appellants separately filed for judicial review. In the application for judicial review made to the High Court, the appellants sought the High Court’s determination on whether the respondent was correct in law to disallow the tax exemption to the appellants under the Exemption Order. The High Court dismissed the appellants’ appeal and held that the appellants were liable to be taxed under the ITA w.e.f their respective dates of election. The appellants then appealed to the Court of Appeal,

which appeal was also dismissed by that Court. (Read the summary of the decisions of these courts in our [e-CTIM TECH-DT 61/2014](#).)

Hence, the present appeal to the Federal Court (the Court). The questions for determination of the Court are (summarized) as follows:

1. Whether the MOF could, by a policy or administrative decision, declare that the exemption conferred by the Exemption Order (which is a subsidiary legislation under the Interpretation Act 1948 and 1967) ceased to apply from a stipulated date without revoking the same;
2. Whether a Labuan offshore company which had made an election under S3A of the LABATA, acquires a vested right that remains so long as the Exemption Order remains in force;
3. Whether an offshore company (now known as a Labuan company for the purpose of the LABATA) which had elected to be taxed under S3B of the ITA, is entitled to the exemption granted under the Exemption Order.

Decision:

Appeal dismissed by a [majority decision](#) of the Court.

The grounds of decision (from the [majority judgment](#)) are summarized below:

1. The Court reviewed the chronological order of relevant amendments to the LABATA and the ITA relating to the taxation of offshore companies/ Labuan entities, following which the following points were made:
 - With the amendment of the ITA through Finance Act 2011, "offshore company" is now construed as a reference to a "Labuan company";
 - Under the same amendments, a Labuan company can elect to either pay tax under the LABATA, or under the ITA;
 - In order to be taxed under the ITA, a Labuan company must make an irrevocable election under S3A of the LABATA. Once an election is made, income from a Labuan business activity by a Labuan company is charged to tax under the ITA, as stipulated under paragraph 2(3)(d) of the LABATA.
 2. Thus, it is the view of the Court ([majority](#)) that

"S2(3) of LABATA reinforces S3B of the ITA and makes it clear that the latter applies in respect of Labuan business activity carried on by a Labuan entity (which includes Labuan company) which makes an election under S3A of LABATA, which under S3B of the ITA (before being amended by Act 719) was a chargeable offshore company"
 3. On reading the Exemption Order, it is clear that paragraph 3(a) exempts from tax dividends received by an offshore company. Under S2 of the Order, offshore company is defined to have the meaning assigned by the LABATA. In the LABATA, an offshore company is construed as a reference to a Labuan company. Therefore a Labuan company that chooses not to elect to be taxed under the ITA, will continue to be taxed under the LABATA, and its dividend income is exempted from income tax under the Exemption Order.
 4. The Court (in its [majority judgment](#)) holds the view that the (relevant) amendments to the ITA and the LABATA were intended to make clear the distinction between a *Labuan company* under the LABATA, and a *chargeable offshore company* under the ITA. Thus, "offshore company" under the Exemption Order must be construed as an offshore company/ Labuan company which is subject to tax under the LABATA, and not to a chargeable offshore company subjected to tax under the ITA.
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5. The wordings of S3B of the ITA and S3A and S2(3) of LABATA as well as the Exemption Order are clear and unambiguous and must be strictly interpreted (*Krishnadas Achutan Nair & Ors v Maniyam Samykano* [1997] 1 MLJ 94). Further, in interpreting the Exemption Order, regard must be given to the aforementioned sections in the ITA and LABATA. Being an Order made under delegated power of the Minister pursuant to S127(3) of the ITA, it must be read subject to and consistent with the provisions of the ITA (S25 of the Interpretation Acts 1948 and 1967 quoted). When read in this way, it becomes very clear that a Labuan company that has elected to be taxed under ITA cannot continue to enjoy the exemption as the Exemption Order was intended to apply to a company that is subject to tax under the LABATA. (Having made the election) *“it is no longer ‘an offshore company’ but ‘a chargeable offshore company’,”* (which was the status of the appellants in this case).
6. The change of status of the appellants to “chargeable offshore companies” happened on the dates that the appellants made their respective elections. With effect from that date, each of the appellants no longer came within the terms of the Exemption Order, and the suggestion by the appellants that they can claim exemption under the Exemption Order is “absurd”.
7. It is clear that the Exemption Order was intended to apply to a company that is subject to tax under the LABATA. Thus the need of revoking the Exemption Order does not arise. Therefore there is no necessity to answer Question 1. The answers to Questions 2 and 3 are in the negative.

From the *minority judgment*

The appeal is allowed. The grounds are summarized below:

1. The dissenting Judges also reviewed the chronological order of relevant amendments to the LABATA and the ITA relating to the taxation of offshore companies/ Labuan entities as well as the chronology of events leading to the application for judicial review by the appellants. Some of the points made are highlighted below:

- It was noted that the following provisions take effect as follows:

S3B of ITA – Effective from YA 2008 and subsequent years of assessment

The Exemption Order – Effective from YA 2007 and subsequent years of assessment

“There would have been no necessity to make the Exemption Order in relation to years of assessment subsequent to 2007 if it was not intended to apply to chargeable offshore companies after the YA 2007 (as, by virtue of section 3B, by the YA 2008 tax would no longer be charged on income in respect of an offshore company except an offshore company which had made an election.)

In our view, the extension of the Exemption Order to the years of assessment beyond 2007 was clearly a transitional measure to enable an offshore company which had made an election to still gain the benefit under section 3B accorded to offshore companies which did not make such election, until such time as the Minister deems it expedient to remove the benefit. When that happens, the cessation of that benefit can only (sic) by way of revocation of the Exemption Order by another order, not by a policy decision expressed administratively.”

- *“Statutorily under the (LABATA) the appellants cannot avoid paying some tax to the respondent, bearing in mind that there is no evidence of any exemption given to them under section 26 of the (LABATA), as opposed to the Exemption Order...(under*

which)...*either very little or no tax will be paid by the appellants under the ITA. Obviously any Labuan company that makes an irrevocable election to tax under the ITA must have benefits in mind, i.e. the exemption from the Exemption Order. There is nothing wrong in the appellants arranging their affairs in order to reduce his tax.....*"

- The following events were noted in the chronology of events leading to the application for judicial review:

- 2011 - Appellants were incorporated (in the month of March.)
- 16.1.2012 - Appellants' tax agent applied for a decision from the respondent in respect of the exemption of dividends received for YA 2011
- 21.2.2012 - Appellants were informed to submit the return for YA 2011 based on their interpretation of the Exemption Order as the MOF had yet to state its policy in respect of the decision requested by the appellants.
- 27.2.2012 - Appellants submitted their tax returns for YA 2011
- 20.6.2012 - Respondent informed appellants that though the exemption under the Exemption Order was available to them, the MOF had decided that, effective 12.2.2010, a Labuan entity that elects to be taxed under the ITA no longer enjoys exemption for income from dividends.

- Since the termination of the exemption was only made known to the appellants on 20.6.2012, at the time of the appellants' incorporation in 2011 "*no one had any inkling that...the exemption had ended on 12.2.2010. In other words, the termination of the exemption was backdated to even prior to the incorporation and election of the appellants.*" Thus "*the inevitable conclusion is that the said policy had led to a retrospective deprivation of a right that was statutorily available way back when exercising the rights of election.*"

2. The Minister has by statutory order, (namely, the Exemption Order) made under power delegated by S127(3) of the ITA, granted exemption to any offshore company in respect of dividend income. "*As the appellants are offshore companies, the Exemption Order therefore applies to them.*"
3. The Exemption Order has the legal status of subsidiary legislation and anything done under any subsidiary legislation is deemed to be done under the Act under which the subsidiary legislation was made (in this case, the ITA). The Exemption Order could be revoked by the Minister of Finance (reference made to S22 of the Interpretation Acts 1948 and 1967) but this was not done.
4. Under S127(5) of the ITA, income exempted is 'disregarded' for the purposes of this Act' and it follows that this section gives the appellants "*vested rights that cannot be taken away unless there exists clear terms that state otherwise.*"
5. The words of the Exemption Order are clear, and therefore must be obeyed. "*By virtue of the ordinary and natural meaning of the Exemption Order and reading S3B of the ITA together with it, there can only be one interpretation, i.e. dividends are exempted from tax under the ITA.*" It is incumbent upon the respondent to put into effect the appellant's statutory right i.e. to exempt dividends from income tax.
6. Under Article 96 of the Federal Constitution, no tax or rate shall be levied by or for the purposes of the Federation except by or under authority of federal law. Parliament may delegate some of the powers to a Minister or any administrative body, but such delegation must be confined to the express authority delegated to it. Although (in this case) the appellants were not burdened with additional taxes, the Court holds the view that by depriving them of the

exemption, the appellants have been financially burdened in another way (*Gruen Watch of Canada Ltd v Attorney General of Canada* [1950] OR 429).

7. The “policy adverted to by the respondent” was never issued pursuant to any power authorized by Parliament (unlike the Exemption Order which is subsidiary legislation) and therefore does not have any force of law. *“In accordance with the settled rules of construction the respondent or Ministry of Finance thus have no jurisdiction to unilaterally and arbitrarily rely on policy to deny the appellants’ entitlement to tax exemption.”*
8. The ineffectiveness of the policy applies to all companies regardless of nomenclature, therefore it *“applies with equal force to any “chargeable offshore company”. In short, the need to discuss the differences between an offshore company and chargeable offshore company in this appeal is unnecessary.”*
9. No time frame is mentioned in the Exemption Order as to its duration. Hierarchical requirement demands that an administrative policy may not rise above a subsidiary legislation, and that requirement must be safeguarded (*Kerajaan Malaysia v. Wong Pot Heng & Anor*[1997] 2 CLJ 188/203). It is clear that the respondent, or the MOF *“has no jurisdiction to unilaterally and arbitrarily declare 12.2.2010 as the cut-off date for the appellants to claim exemption for its dividend income by way of policy.”*

Members may read the full [Majority](#) & [Minority](#) Judgments of the Federal Court of Malaysia at the www.kehakiman.gov.my website.

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