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TECHNICAL

Direct Taxation

TAX CASE UPDATE

WITHHOLDING TAX ON MANAGEMENT FEE, LEGAL FEE AND CONSULTANCY FEE PAID TO NON-RESIDENTS.

KPHDN v MUDAH.MY SDN BHD

Court of Appeal at Putrajaya
Civil Appeal No: W-01(A)-342-10/2015
Date of Judgment: 14 February 2017

Facts and Issues:

This is an appeal against the decision of the High Court dated 15.9.2015, to grant an Order of Certiorari to quash the decision of the appellant (KPHDN) that: -

(a) no or no sufficient withholding taxes have been paid by the respondent (Mudah.My Sdn Bhd) for the years of assessment (YA) 2010, 2011, and 2012 and the penalties to be imposed under the Income Tax Act 1967 (ITA);

(b) various payments such as "Management fee, Legal fee and Consultancy fee" paid to non-residents are subject to withholding tax (WHT) under S109B, and penalties to be imposed under the ITA, on the premise that it is ultra vires, null, and void.

(All sections cited hereinafter refer to sections in the ITA, unless otherwise stated.)

The above were contained in the appellant's "letter of findings" dated 10.7.2014 to inform the respondent of the initial findings and issues raised following a field audit which was conducted at the respondent's office on 10.6.2014. The "findings" in the letter were based on documentation furnished by the respondent during the field audit. 3 meetings between the appellant and the respondent were held after the issue of the letter of findings, with the intention of discussing and revising the findings of the audit. Further documentation was furnished by the respondent during the third meeting. A fourth meeting was cancelled at the behest of the respondent.

After the cancellation of the fourth meeting, the appellant discovered that the respondent had filed the application for judicial review on 9.10.2014 which was directed against the appellant's letter of findings and claimed that the appellant had assessed tax and imposed penalty for the YA 2010, 2011 and 2012. **To date, the truth is, the appellant has yet to demand payment of the WHT in question.**

The "core of the appeal" before the Court of Appeal ("the Court") was directed on the issue whether the High Court had erred in deciding that the letter of findings was tantamount to a decision, and if the answer:

- is negative, whether the application for judicial review was prematurely filed; (or)
- is affirmative, whether the High Court had erred in deciding that the application for judicial review was an appropriate route of appeal as a specific appeal procedure is available/ provided under S109H.

Decision:

Appeal allowed. Order of the High Court dated 15.9.2015 was set aside. The grounds of decision

are summarized below:

1. **Submissions**

1.1 The **Appellant** contended that the letter of findings was neither conclusive nor finalized and that the judicial review application had been prematurely filed, in short, the letter of findings did not constitute a decision.

1.2 The **Respondent** submitted that the application was not premature as the appellant had already come to a decision, that being the decision which came within the ambit of Order 53 of the ROC 2012.

2. **Decision of the Court**

2.1 For a decision to be quashed on judicial review or susceptible to the court's reviewing powers, there must first be a decision by a decision maker, and that decision must affect the aggrieved party by either altering the rights or obligations or depriving him of the benefits which he had been permitted to enjoy. Based on this principle, certiorari will not lie to quash a decision if no such decision has been made by a public authority.

2.2 After examining the letter of findings in its entirety, the Court found that the letter merely informed the respondent of the initial findings and issues of the field audit based on documentation furnished by the respondent, who was requested to attend a meeting with the appellant for the purpose of discussing the findings with a view to finalizing these findings. The conduct of the respondent in attending subsequent meetings evinced knowledge on their part that the initial findings stated in the letter of findings had yet to be finalized and was therefore, not a decision. This finding of the Court (that the letter of findings was not a decision, neither was it conclusive nor finalized) was also supported by the fact that the respondent had admitted that to date, the appellant had yet to demand payment of the WHT in question.

2.3 The facts showed that at all material times, information and assistance were given to the respondent (who was given ample opportunities to discuss the findings and furnish further documents) so that they could rightfully discharge the burden of disproving the contents of the letter of findings and to enable them to prepare their appeal when a decision is made by the appellant. Based on these facts, there was no breach of natural justice as this was strictly observed by the appellant in adopting the approach which was procedurally correct.

2.4 There was no assessment made by the appellant in the letter of findings. Based on the case of *Marulee (M) Sdn Bhd v Menteri Sumber Manusia & Anor* [2007] 5 CLJ 51, the Court held that (there being no decision of the Director General (DGIR) in the sense that no assessment had been made), not only did the respondent lack sufficient interest or locus standi to make an application (for judicial review), but the application was patently premature. It also meant that there was no decision from which the Court could justifiably say that the respondent was thus adversely affected and thus order it to be quashed.

2.5 The finding that there was no decision made in this case which was amenable to judicial review also led to the conclusion that this case was eminently one which did not come within the ambit of Order 53 of the ROC 2012 and therefore was an appropriate case that an order for judicial review ought not to be allowed. Indeed it would be manifestly impossible and legally incorrect to allow judicial review in this case.

2.6 Regarding the second issue for determination, on which the appellant had contended that the respondent's application for judicial review was inappropriate and an abuse of the process of court as the respondent had failed to resort to the appeal procedure provided under the ITA, it was emphasized that the Court's deliberation on this issue was made on the **assumption** that the letter of findings contained a decision by the appellants. The Court proceeded to examine the provisions of S109H, and concluded that it was "an irrefragable fact" that the respondent had failed or refused to avail themselves of the

remedy of the appeal process.

2.7 Based on principles established in various precedent cases, the approach to be adopted was summarized as follows:

"*Generally, if the taxpayer can demonstrate illegality or unlawful treatment, then it would be wrong to insist on exhaustion of local remedy…..in certain cases, appeal procedure was provided under the statute but if the applicant can demonstrate excess or abuse of power or a breach of natural justice, judicial review would be granted*."

However, in the present case, the Court found as follows:

"*In our judgment, there was no clear lack of jurisdiction for the field audit conducted by the appellant was within its statutory powers….neither was there any proof of a blatant failure by the appellant to perform its statutory duty nor any serious breach of natural justice*."

It went on to state that "*in the absence of special or exceptional circumstances, the application for judicial review is not an appropriate route of appeal and in fact an abuse of the process of court."*

2.8 The Court addressed the issue of "special circumstances" under which it would be appropriate for the Court to subject the case to judicial review. It referred to the respondent's contention that the transactions discovered during the audit in relation to payments for software, were neither royalties nor subject to WHT. It was pointed out that the fact that payments were made to the non-residents was not disputed. The Court then declared that, having perused the relevant documentation and exhibits, it found that "*there was a good deal of substance in the argument put forward by the appellant that the payments…..to the non-resident companies were for the 'right to use' within Malaysia, as such these payments were payments of royalty*." Hence, in the Court's view, "*the payments fell within the definition of 'royalty' under section 2 of Act 53*,….(therefore) *subject to the withholding taxes*."

2.9 The following points were made in support of the above finding:

- The definition of the word "royalty" in S2 is given "wide and non-exhaustive interpretation" by the use of the word "includes" (citing definitions of the latter word from several "authorities" including 2 publications, *Black's Law Dictionary*, and *Stroud's Judicial Dictionary of Words and Phrases)*. Based on these authorities, the Court was of the opinion that the "*the definition of the word "royalty" ought to be taken in its widest sense and ought not to be limited only to any sums or income included in section 2 of Act 53".* The Court then made the finding that, based on the facts, the payments in question *"were for 'the right to use', thus falling very well within the scope of 'royalty' under section 2 of Act 53 and accordingly, were subject to withholding taxes*."
- Evidence tendered in court showed that the payments in question were for the "right to use". Evidence marked as Exhibits AD-27 and AD-28 showed the following:
  (a) (Exhibit AD-27)– Schibsted Iberica SRL (the other party to the Standard Consultancy And Licence Agreement) granted licence to the respondent to use the software within Malaysia where its exclusive ownership belonged to the former;
  (b) (Exhibit AD-28) – wherein it was stated that the licence for software was given to the respondent, however, the same was not transferable.
- The Court agreed entirely with the pronouncement made in the case of *Commissioner of Income Tax v Davy Ashmore India Ltd* [1991] 190 ITR 626 where it was held that where the owner retained the property in the product and permitted the use or allowed the right to use the property, payment received for that was royalty. Accordingly, the Court concluded that "*if the owner of a design, know-how or intellectual property right allows the use of or any right and retains the right, the payment for the right to use of the said design, know-how or intellectual property right is to be treated as royalty*."

- The payments to the non-residents were for the use of software. S7(1)(a) of the Copyright Act provides that "literary works" is eligible for copyright, and under S3 of the same Act, "literary works" is defined to include computer programs [under item (h)]. Therefore, payments for the use of literary works (which include computer programs) were subject to royalty, as literary works were eligible for copyright. Following the granting of the right to use software by the non-resident companies, the respondent had to make payments to these non-resident companies, which payments were subject to WHT pursuant to S109(1).

2.10 On the contention that the evidence showed that the payments did not pertain to services performed in Malaysia, and therefore should not be subject to WHT, the Court posited that S109(1) does not explicitly stipulate that the services by the non-resident company must be performed in Malaysia, but only requires WHT to be deducted and paid to the DGIR within one month after paying the royalty. *("Nowhere does the section stipulate that the service must be rendered in Malaysia.*") In any event, the evidence showed that the services were provided within Malaysia.

2.11 The Court's findings are summarized as follows:

- The respondent did not have justification for judicial review of the appellant's audit findings and issues. The application was an abuse of the court's process and prematurely filed.
- The appellant's findings that the payments to the non-resident companies were undoubtedly subject to WHT were correct.
- The Special Commissioners of Income Tax (SCIT) was the right forum to decide on the respondent's complaints by way of an appeal as the salient issues involved in the application for judicial review were made up of questions of fact and law, which were within the competence and power of the SCIT to deal with.

Members may read the full Grounds of Judgment at the Institute's website and the LHDNM website.