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CHARTERED TAX INSTITUTE OF MALAYSIA (225750-T)

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TECHNICAL

Direct Taxation

TAX CASE UPDATE

Withholding tax on distribution fees paid to a tax resident of Switzerland.

KPHDN v THOMSON REUTERS GLOBAL RESOURCES

High Court of Malaya at Kuala Lumpur
Appeal No. 14-6-11/2014

Date of Judgment: 19 May 2016

Facts and Issues:

This is an appeal against the decision of the Special Commissioners of Income Tax (SCIT) who had allowed the appeal of the respondent in this case, Thomson Reuters Global Resources (the "Taxpayer"), a tax resident of Switzerland with operations exclusively in Switzerland. The Taxpayer had appealed to the SCIT against the decision of the Inland Revenue Board of Malaysia (IR) which rejected the taxpayer's request to refund withholding tax (WHT) on distribution fees received by the taxpayer, which was "erroneously remitted" to the IR.

The Taxpayer was in the business of compiling, producing, developing and selling "information services and dealing services". These included news, financial and economic information as well as the capacity to negotiate and conclude trades (dealing services). The services were provided from Switzerland by the Taxpayer and it had no permanent establishment in Malaysia.

Under an agreement referred to as the "Local Vendor Agreement: Information and Dealing Services" (the "Agreement") which became effective from 1.1.2010, the Taxpayer appointed Thomson Reuters Malaysia Sdn Bhd (TRM) to market and sell the Taxpayer's products in the form of "information services" and "dealing services" in Malaysia. TRM also provided sales and marketing related services including customer support to its customers in Malaysia. Both parties to the Agreement were ultimately owned by Thomson Reuters Corporation.

Pursuant to the Agreement, the Taxpayer received distribution fees from TRM. These fees were recorded and treated as business profit of the Taxpayer in Switzerland and were taxed as such by the tax authority of Switzerland. The payment (of distribution fees) was only for the distribution of the Taxpayer's products in Malaysia and not to exploit any of the intellectual property rights of the products as reflected in Clause 5 of the Agreement.

For the year of assessment (YA) 2010, the Taxpayer took the position that distribution fees payable to itself by TRM was its business profit in Switzerland subject to Swiss income tax, and no WHT was deducted, except for one payment tranche made on 31.5.2010. This particular payment was "inadvertently subjected…to WHT" and WHT amounting to RM 1.6 million was "erroneously remitted" to the IR. The IR was informed of the error on 9.8.2010 and a request was made for the "*WHT that was inadvertently paid to be refunded to the Taxpayer through TRM*".

The Taxpayer's request was rejected by the IR on the basis that the said distribution fees was

subject to WHT as it fell within the definition of royalty under the Income Tax Act 1967 (ITA). The Taxpayer appealed to the SCIT against the IR's decision, which appeal was allowed by the SCIT.

Hence this appeal to the High Court (the "Court"). The issues for determination were:

1. Whether the findings of fact by the SCIT could be disturbed in this appeal.
2. Whether distribution fees paid to the Taxpayer by TRM was "royalty" under Article 12(4) of the Double Taxation Agreement between Switzerland and Malaysia (the "DTA")
3. Whether distribution fees paid to the Taxpayer was the business profit of the Taxpayer and thus only subject to tax in Switzerland under Art. 7(1) of the DTA.

Decision:

Appeal dismissed. The grounds of the decision are summarized below:

(All sections mentioned hereinafter are from the ITA, unless otherwise stated.)

1. Among the arguments submitted by the IR are the following:
   - The IR referred to S4(d) (income from rents, royalties or premiums), S2 (definition of "royalty"), and S3 of the ITA. Collectively (as submitted by the IR) these are the charging provisions to impose WHT.
   - Because the Taxpayer's products are specialized knowledge, it comes within the definition of "royalty" in S2. Furthermore, because the Taxpayer retains the intellectual property rights of the products, the distribution fee received by the Taxpayer is a royalty.
   - There is no conflict in the definitions of royalty in S2 of the ITA and Art. 12(4) of the DTA.
2. The Taxpayer made the following submissions:
   - The SCIT had made findings of fact which cannot be easily disturbed by this Court, a proposition which is well supported by case law.
   - Distribution fee received by the Taxpayer is not royalty but business profit to the Taxpayer, subject to tax only in Switzerland and therefore, not subject to WHT in Malaysia.
   - The provisions of the Agreement (as found by the SCIT) indicate that no royalty is involved and it is stated in the Agreement that the distribution fee is a business profit of the Taxpayer in Switzerland.
   - The definition of royalty in Art. 12(4) of the DTA is applicable and if there is a conflict (with the definition of the ITA) the DTA should prevail.
3. The Court found as follows:

   Issue 1.

   - The Court referred to the following cases –
     I Investment v Comptroller General of Inland Revenue [1975] 2 MLJ 208
     Chua Lip Kong v DGIR [1982] 1 MLJ 235

     Based on the above cases, the Court came to the conclusion that it should "*refrain from using the slightest reasons to disturb the findings made by the SCIT…*", which "*should be accorded due respect it deserved".*

   Issue 2

   - The Court made reference to DGIR v Euromedical Industries Ltd [1983] CLJ (Rep) 128 and quoted at length from Damco Logistics Malaysia Sdn Bhd v KPHDN [2011] MSTC 30-033, which were referred to as "authorities" for the present case.
   - Based on these authorities, the definition of "royalty" as found in the DTA should be preferred over that which is provided in the ITA.
   - There was no reason for the Court to discard the findings of the SCIT that the distribution fee was not a royalty. The SCIT had stated in their findings that –
     - "(t)*he business and products of the Taxpayer in the present appeal*…..(are found) *to be*

very similar in category to the Electronic Data Processing Systems developed by APMM in Damco (supra)", and

- "*the nature of the payment called distribution fee made by TRM under the Agreement in present appeal…..is also very similar in category to the nature of the payments in Damco (supra*).."
- *"…TRM does not have the right to reproduce the products in Malaysia; nor to exploit any of the intellectual property rights of the products…"*

- There was also no reason to find that the distribution fee should be categorized as royalty because the services rendered cannot be considered to involve any special commercial knowledge, but was only providing information and business contents to TRM, the payer of distribution fees.
- There was also no transfer, grant or the use of know-how or propriety rights in consideration of the distribution fee. The Taxpayer merely provided information services to TRM.

Issue 3

- It was "crystal clear" that under Art. 7(1) of the DTA, distribution fees received by the Taxpayer should only be subjected to tax in Switzerland where the Taxpayer operated, "*more so when the SCIT had found that the Taxpayer operate(d) no permanent establishment in Malaysia*. *Therefore it is plainly wrong for the IR to impose WHT here in Malaysia."*

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