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TECHNICAL

Direct Taxation

TAX CASE UPDATE

Does S142(5) of the Income Tax Act 1967 prevail over S126 of the Evidence Act 1950?

BAR MALAYSIA v KPHDN

High Court of Malaya in Kuala Lumpur
Originating Summon No. WA-24-12-03/2017
Date of Judgment: 2 April 2018

Facts and Issues:

The Plaintiff filed an Originating Summon dated 7.3.2017 against the Defendant seeking the following relief: -

i. a Declaration that Section 142(5) of the Income Tax Act 1967 ("ITA") does not entitle nor empower the Defendant to disregard the privilege under Malaysian law that protects all communications, books, objects, articles, materials, documents, things, matters or information passing between an Advocate and Solicitor and his/her client or advice given by an Advocate and Solicitor to his/her client, whether contained in any book, statement, account or other record of any description whatsoever (hereinafter collectively referred to as "Client Communications"), and which privilege is referred to variously under Malaysian law as "legal professional privilege", "solicitor-client privilege" or "legal privilege" (hereinafter referred to as "Privilege") by requesting or demanding access to, or disclosure of, such Client Communications from any Advocate and Solicitor, unless Privilege is waived by the client;

ii. a Declaration that Part V of the ITA generally, and Section 80 of the ITA in particular, do not entitle nor empower the Defendant to disregard the Privilege that protects all Client Communications by requesting or demanding access to, or disclosure of, any such Client Communications from any Advocate and Solicitor, unless Privilege is waived by the client;

iii. a Declaration that Privilege under Malaysian law generally, and as referred to in Sections 126, 127, 128 and 129 of the Evidence Act 1950 ("EA") in particular, require an Advocate and Solicitor to reject any request or demand of the Defendant for access to, or disclosure of, any Client Communications, unless Privilege is waived by the client.

The Plaintiff had received complaints from members of the Malaysian Bar that officers of the Defendant had been conducting tax audits of members' law firms and their client accounts and had insisted on being given access to accounting books and records pertaining to such client accounts. Taking the stance that such audits would breach the principle of solicitor-client privilege ("Privilege"), and that S142(5) of the ITA should not and does not prevail over Privilege, the

Plaintiff wrote to the Defendant on its stand in a letter dated 3.11.2016, and received the reply in a letter from the Defendant dated 7.12.2016. In the letter, the Defendant stated that he had a duty to conduct audits to ensure that all tax assessments are made in accordance with provisions of the ITA, and he took the stand that S142(5) of the ITA overrides (specifically) the provisions of Chapter IX of Part III, of the EA and the Legal Profession Act 1976 ("LPA").

Furthermore, the Defendant's officers are empowered under S80(1) of the ITA to have full and free access to all lands, buildings and places, and to all books and documents etc. Therefore, failure to give access as provided under that section is a breach of the ITA, and is punishable under S116(a) of the ITA.

The question of law for the Court to decide was whether S142(5) of the ITA prevails over S126 of the EA as there is conflict between both provisions.

Decision:

The Court declared the answer to the above question to be in the negative. The application was allowed. The conclusions arrived at by the Court were summarized in the judgment as follows:

1. Privilege is absolute unless it is waived by the privilege holder or falls within the proviso to S126 of the EA and it therefore affords protection to clients and not to lawyers.
2. It is not open for the Defendant to have any access to the client's account with a view to checking whether the law firms have understated their income without reasonable suspicion of misconduct or criminal conduct on the part of the law firm.
3. The Defendant cannot be allowed to use the ITA as an instrument of fraud purportedly to fish for information on the clients of the law firms.
4. The non-obstante nature of S142(5)(b) of the ITA ought to be read in accordance with the actual words of Parliament;
5. S142(5)(b) of ITA, at most, only has the effect of removing privilege in respect of any book, account….or other record prepared or kept by "practitioners" such as tax accountants and tax agents with a view to taxing their clients and it does not extend to "advocates and solicitors."
6. In S142(5)(b) of ITA, Parliament had clearly used different words as it recognized that "practitioners" and "advocate and solicitor" are different persons.
7. S142(5)(b) of ITA does not oust the common law on Privilege.
8. Based on the clear and express language in Section 126 of the EA it cannot be disputed that S126 of the EA is the specific provision which governs matters pertaining to Privilege. The Defendant has misunderstood and misapplied the Latin maxim of *Generalia Specialibus Non Derogant.*

The grounds of the decision are summarized below:

1. The Defendant contended that the overriding effect of S142(5)(b) of the ITA extended to the operation of S126 of EA (which lies within Chapter IX Part III of EA) as connoted by the phrase "*save as provided in para (b)"* in S142(5)(a) of the ITA. The Court is of the view that this argument was misconceived. The Court's own interpretation is stated as follows:

> "*My reading of (*S142(5)(a) and (b) of the ITA*) is that only paragraph (b) of section 142(5) of the ITA excludes or overrides privilege conferred in other written law. The Act does not affect the operation of Chapter IX of Part III of the Evidence Act 1950 …or be construed as requiring or permitting any person to produce or give to a court, the Special Commissioners, the Director General or any other person any document, thing or information on which by that Chapter or those provisions he would not be required or permitted to produce or give to a court."*
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> *"……Paragraph (b) saves Chapter IX of Part III of the EA from operation of ITA. In other words Section 126 of the EA which lies within Chapter IX Part III of EA is saved and not caught under S142(5) of the ITA. Section 126 of The EA shall prevail over section 142(5) of the ITA ….."*
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> *"The wordings of S142(5) of ITA is clear and unambiguous and it should not be misinterpreted or assigned with another meaning."*

2. Care must be exercised in construing the non-obstante nature of S142(5) of the ITA to give effect to the intention of Parliament. In this section Parliament has clearly used different words as it recognized that "practitioner" and "advocate and solicitor" are different persons and significance must be given to every word of an enactment. The Court agreed with the Plaintiff that the terms "practitioner" and "advocate and solicitor" in S142(5) are meant to refer to different persons, and this forms the basis for its view that that section only has the effect of removing privilege in respect of any book, account, statement or other record prepared or kept by "practitioners" such as accountants and tax agents, with a view to taxing their clients, and it does not extend to "advocates and solicitors."

3. The Court is also of the view that the words "notwithstanding the provisions of any other written law" in S142(5)(b) of the ITA does not exclude the operation of common law, and Parliament did not intend to apply that section to the exclusion of common law on Privilege. At most, S142(5) may only apply to the possible secondary cases.

4. The Defendant has misunderstood and misapplied the Latin maxim of *Generalia Specialibus Non Derogant.* Based on the clear and express language in S126 of the EA it cannot be disputed that the EA is the specific statute which governs matters pertaining to Privilege, and thus, S126 is the specific provision on Privilege that excludes the operation of the general provision of S142(5) of the ITA to the extent of any inconsistency.

5. The Defendant submitted that it is necessary to gain access to clients' accounts to ensure that the law firm was not using these accounts as a means to park its own income which will then result in an understatement of income by the respective law firm. In reply, the Plaintiff contended that the Defendant had sought to use an Act of Parliament (in this case, the ITA) as an instrument of fraud purportedly to (unlawfully) fish for information on the clients of the law firms, and that such "*unmeritorious conduct*" (on the part of the Defendant) "*is abusive, unlawful and illegal*." The Court's own observation on this matter is stated as follows:

> "W*hile the Defendant may have its own purpose and objective, however any action done must be in accordance with the law….the Defendant relied on S142(5) of the ITA to view "client's account". But while I agree that (S142(5)) does not protect privilege communication or documents in other written law, the fact remains that solicitor-client privilege under S126 of the EA which lies within Chapter IX Part III of EA is not affected by the operation of the ITA."*

and further on, declared –

> "*In my considered opinion, before the Defendant is required to view the "client's account"*

there must be some information of some illegal act/ purposes and/ or any crime of fraud or reasonable belief that the Plaintiff has used the client's account as a means to park the law firm's own incomes which resulted to an understatement of income by the respective law firm which warrant an investigation."

Members may read the full Grounds of Judgment at The Malaysian Bar's website.

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