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TECHNICAL

Direct Taxation

TAX CASE UPDATE

DGIR's decision to tax proceeds from sale of "marketing and manufacturing intangibles" – application for judicial review

KEYSIGHT TECHNOLOGIES MALAYSIA SDN BHD v KPHDN

High Court of Malaya in Kuala Lumpur
Application For Judicial Review No. WA-25-165-06/2017
Date of Judgment: 3 Jan 2018

Facts and Issues:

The applicant is a company incorporated in 1998 under another name which was changed to Agilent Technologies Microwave Products (M) Sdn Bhd ("Agilent") in 1999, and again, to Keysight Technologies Malaysia Sdn Bhd from 2014. In 2008, Agilent entered into a manufacturing services agreement with Agilent Technologies International Sarl, Switzerland (ATIS) and was then converted from a full-fledged manufacturer into a contract manufacturer. Following this, it was stated by the applicant that it no longer owned any marketing and manufacturing intangibles as these rights had been sold and transferred to ATIS.

Following an audit conducted on the applicant by the DGIR in 2013, the applicant was requested by the DGIR to provide clarifications on the sale of Intellectual Property Rights (IPR) to ATIS in a letter dated 9.3.2017. The reply was given in a letter dated 28.3.2017.

The applicant was informed in a letter from the DGIR dated 9.6.2017, that after examining the facts and information furnished by the applicant, the DGIR was of the view that gains from the transfer of "technical know-how" amounting to RM821,615,000 reported in the year of assessment (YA) 2008, were revenue income falling under S4(f) of the Income Tax Act 1967 (ITA) and were subject to income tax. (All provisions cited below are from the ITA unless otherwise stated.)

It was also stated in the letter that:

- Additional assessment for YA 2008 would be issued under S91(3) in consequence of the applicant's negligence in failing to report the income mentioned above, and penalty of 45% would be imposed under S113(2). (A revised tax computation was attached.)
- The DGIR had found issues relating to withholding tax (WHT) on expenses incurred on product royalties paid for the YA 2006 – 2008 (set out in another attachment) and the applicant was asked to forward receipts as proof of payment of WHT for the relevant YA.

The applicant was then issued with Notices of Additional Assessment dated 13.6.2017 for additional tax of about RM311 million. The company proceeded to file this application for judicial review on 20.6.2017. Among the Orders prayed for were the following Orders of Certiorari to quash the DGIR's decisions as stated in his letter dated 9.6.2017, including the following –

i. the sale of marketing and manufacturing intangibles to ATIS is revenue in nature that qualifies as income under S4(f) of the ITA;
ii. the sale of IPR to ATIS is revenue in nature and not capital in nature; and
iii. no or no sufficient WHT have been paid by the applicant for YA 2006 – 2008 and for penalties

to be imposed under the ITA.

The Orders prayed for also included an Order of Prohibition for the purpose of preventing the DGIR (respondent) from issuing any assessment as it was out of time by virtue of S91(1), more so as the respondent has not proved negligence on the part of the applicant as required under S91(3).

On 10.7.2017, the applicant also filed an appeal under S99 of the ITA against the additional assessments dated 13.6.2017.

Decision:

The notice of application was dismissed. The grounds of the decision are summarized below:

1. The Court reviewed the principles established in precedent cases[1] and summed up its conclusion as follows:

   "*Therefore, in an application for leave for judicial review, the applicant must show that such application is not frivolous or vexatious and if the leave was granted, an arguable case in favour of granting the reliefs sought at the substantive hearing might be the result."*

2. On the question of whether the application was premature, the court referred to the case of KPHDN v. Mudah.my Sdn Bhd [2017] 2 MLJ 197; [2017] 5 CLJ 283 and concluded that:

   "*Therefore, the first issue here is whether the DGIR has made a decision which must affect the rights of the applicant. In this case involving tax matters, the applicant is seeking to impugn the letter of the DGIR dated 9.6.2017. Having examined the contents of the said letter, I am of the considered opinion and I agree with the DGIR's submission that the said letter merely states the opinion of the DGIR of the tax treatment under the ITA 1967 for transfer of technical knowhow arising from the transfer pricing audit conducted by DGIR for the YA 2008."*

3. The Court went on to state that it agreed with the DGIR that the letter dated 9.6.2017 merely set out the findings by the DGIR and cannot be regarded as imposing any liability on the applicant. Pending the issuance of an additional assessment, the letter could not be enforced against the applicant. As such the applicant should have waited for the notice of additional assessment before filing for judicial review as the applicant was only "aggrieved" upon being issued with the notice of additional assessment on 13.6.2017.

4. Support for the above position was derived from the following cases:

   - M.W.Zander (M) Sdn Bhd v DGIR [2005] 6 CLJ 336
   - Flextronics Shah Alam Sdn Bhd v KPHDN [Permohanan Bagi Semakan Kehakiman No. 25-2-01/2015] and [Rayuan Sivil No. W-01(A)-187-05/2016] (Court of Appeal)

   Based on the above cases, the Court was of the opinion that until the DGIR issued a notice of additional assessment under the ITA (which he did on 13.6.2017) there was no decision, omission or action which had adversely affected the applicant within the context of Order 53 Rule 2(4) of the Rules of Court 2012 in the letter dated 9.6.2017. Therefore the Court found the application to review the letter dated 9.6.2017 to be premature.

5. On the issue of whether this application should be dismissed as the applicant should have proceeded with the appeal process provided under S99 of the ITA, the following cases were referred to:

   - Government of Malaysia & Anor v. Jagdis Singh [1987] 2 MLJ 185
   - Majlis Perbandaran Pulau Pinang v Syarikat Bekerjasama-sama Serbaguna Sungai Glugor dengan Tanggungan [1999] 3 MLJ 1
   - Ta Wu Realty Sdn Bhd v. KPHDN & Anor. [2004] 6 MLJ 53

- KPHDN v. Mudah.my Sdn Bhd (supra)
- KPHDN v. Alcatel-Lucent Malaysia Sdn Bhd & Anor. [2017] 1 MLJ 563 (FC)

After reviewing these authorities, the Court was of the view that this case did not come within the exceptions enumerated in the first 2 cases listed above:

> "*There is no issue of a lack of jurisdiction when the DGIR issued the said letter dated 9.6.2017. Added to that, the applicant has also failed to show an excess or abuse of power or breach of the rules of natural justice in the issuance of the said letter.*"

6. The applicant had submitted that the appeal under S99 of the ITA was not a reasonable or legitimate route for the applicant as it would be required to pay the high additional taxes of RM311 million, which would cause irreparable damage to the applicant. According to the applicant, this would fall within the "*exceptional circumstances*" in Jagdis Singh's case. However, the Court disagreed with this submission and took note that in that case, the Supreme Court held that exceptional circumstances are lack of jurisdiction, or a blatant failure by the DGIR to perform some statutory duty, or there was a serious breach of the principles of natural justice. In the present case, there were none of these special circumstances which would merit a review of the case by the Court.

Notes:
1. WRP Asia Pacific Sdn Bhd v Tenaga Nasional Bhd [2012] 4 CLJ 478; [2012] 4 MLJ 296; Peguam Negara Malaysia v. Nurul Izzah bt. Anwar & Ors [2017] 5 CLJ 595;

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