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TECHNICAL

Direct Taxation

TAX CASE UPDATE

Application for judicial review (JR) against Revenue's refusal to apply Advance Ruling on sale of Intangible Asset.

SKF BEARING INDUSTRIES (MALAYSIA) SDN BHD v KPHDN

High Court of Malaya at Seremban in Negeri Sembilan Darul Khusus
Application for JR No: NA-25-3-10/2017
Date of Judgment: 31 Oct. 2018

Facts and Issues:

This is an application for JR under Order 53 Rules of Court 2012, under which the applicant (SKF) sought (amongst others) the following reliefs –

(a) an order for Certiorari to quash the decision of the respondent (KPHDN) on 19/9/2017 in refusing to apply the *Advance Ruling dated 13/9/2012 issued by the respondent under S138B of the Income Tax Act 1967* ("the AR"), on the sale of the applicant's intangible asset for the sum of RM 400.7 mil. ("the said sum").

(b) a declaration that the AR applied to the sale of intangible asset by SKF for the said sum;

(c) a mandamus to compel the respondent to apply the AR on the sale of intangible asset by SKF for the said sum.

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

The following are the relevant facts:

SKF is a company incorporated under the Companies Act 1965. It belongs to the SKF group of companies (SKF group) under the holding company, Aktiebolaget SKF (SKF Sweden) which was incorporated in Sweden. SKF is engaged in the manufacturing of rolling bearings and related components.

SKF Sweden and companies in the group carried on research and development (R&D) in the manufacture of bearings. Participation and contributions of member companies were governed by a Cost Sharing Agreement (CSA) dated 1/1/1997. R&D activities under this CSA had yielded output in the form of intangibles such as patents, designs and know-how. In accordance with the CSA, administration and implementation of R&D activities came under the charge of SKF Sweden, while each participating company has rights of ownership and an undivided interest in the "intangible asset" (IA) which can be exploited commercially by each participant without charge.

In 2011, SKF Sweden had plans to restructure the global operations of the SKF group by centralizing ownership of the IA under SKF Sweden. Under the proposal, SKF Sweden will acquire legal and beneficial ownership of the IA from SKF and assume all trading and economic risks associated with the products and trade. After the sale by SKF, it (SKF) will no longer have any right or access to the use of the IA, hence no beneficial ownership in the IA any more.

Following the proposed transaction, SKF will cease to be a "full-fledged manufacturer" as it no longer has the rights to commercially exploit the IA and will become instead, a contract manufacturer to SKF Sweden. To compensate SKF for giving up its ownership (beneficial and economic) of the IA, SKF Sweden will make a one-off payment to SKF.

Subsequently, the significant events that took place from 2011 to 2017 are as follows –

Date	Event
1/12/2011	SKF entered into a Contract Manufacturing Agreement (CMA) with SKF Sweden which took effect on 1/1/2012.
6/4/2012	SKF, through its tax agent, requested for an Advance Ruling from KPHDN regarding the tax treatment of the said sum.
13/9/2012	After requesting for and obtaining the relevant information and documents from SKF, KPHDN issued the AR which stated that the said sum is regarded as a capital receipt not subject to tax under the ITA.
26/10/2012	SKF and SKF Sweden signed an Intangible Property Sale Agreement for the sale of the IA by SKF to SKF Sweden for the said sum. Relying on the AR, the said sum was treated by SKF as a capital receipt not subject to tax for YA 2012.
4/4/2017	Following a tax audit, KPHDN issued a letter informing SKF that the said sum was a revenue receipt which was subject to income tax.
21/4/2017	SKF wrote to inform KPHDN that it acts only as a contract manufacturer for SKF Sweden and no longer contributes to R&D activities or holds product liability risks, and sells the products to companies in the SKF group. Also pointed out that the tax treatment of the said sum was in accordance with the AR which it had obtained from KPHDN.
10/8/2017	KPHDN informed SKF in a letter that SKF has maintained its beneficial interest in the IA as a contract manufacturer and therefore the AR is not applicable any more.
19/9/2017	After discussions between SKF and KPHDN, the latter reiterated in a letter on this date, that the said sum was not a capital receipt for the loss of an asset, but represented a substitution of income under the planned reduction of the profit margin through the restructuring process, as well as income taxable under S.4(f) of the ITA. A Notice of Additional Assessment (NAA) of the same date was attached, notifying additional tax (with penalty) payable in the amount of RM145,253,750.
5/10/2017	SKF filed an application for leave to commence proceedings for JR.
12/10/2017	Leave was granted by the High Court for above.
13/10/2017	SKF filed Form Q for appeal to the Special Commissioners of Income Tax (SCIT) against the NAA dated 19/9/2017 for YAs 2010, 2011 and 2012.

Decision:

The application was not granted as it was an abuse of the Court process. The application was without merit and without any basis in law.

The grounds of decision are summarized below:

1. Counsel for KPHDN argued that the decision which was the subject of JR was made in accordance with what is allowed under S138B and the Income Tax (Advance Rulings) Rules 2008 ("the AR Rules"). The applicant has failed to show exceptional circumstances which warrant the granting of JR. The case should rightly be heard and decided by the SCIT.
2. S99 contains provisions for filing an appeal to the SCIT. Applying the principle applied in *KPHDN v Mudah.my Sdn Bhd [2017] 5 CLJ 283* –

> "*where there was an alternative remedy of appeal, leave to bring judicial review proceedings would only be granted in exceptional circumstances would entail the necessity on the part of the respondent* (in the case cited) *to show to our satisfaction the existence of such exceptional circumstance*"

to the present case, Court sought to examine the circumstances of the case to see if there are any exceptional circumstances to warrant the exercise of its discretion for JR.

3. The Court referred to the following Rules in the AR Rules –
   i. Rule 2(3) – provides for AR to be issued only for an "*arrangement that are* (sic) *seriously contemplated*" by the applicant;
   ii. Rule 3(a) – the DGIR shall not make an AR where at the time the application is made or at any time before the AR is issued, the applicant has entered into or effected the arrangement for which the AR is sought.
4. In the present case, exhibit "A-13" tendered in Court showed that the applicant had entered into an agreement (CMA) with SKF Sweden on 1/12/2011, i.e. prior to the application for AR on 6/4/2012, under which SKF became a contract manufacturer for SKF Sweden, with the latter becoming the owner of the IA on 1/1/2012. Hence an arrangement had been entered into and effected before the application for AR was made. This fact was not disclosed to the respondent in the application for AR. Hence there was a failure to fulfill the requirements that the arrangement must be "*seriously contemplated*" and not yet "*entered into or effected*" at the time the application was made.
5. Information relating to the CMA was not furnished to the respondent. This could be regarded as a material omission which comes within the exclusions from application of an AR under provisions of S138B(6)(b). In addition, Rule 15 of the AR Rules was also violated as the Return Form for YA 2012 furnished by SKF showed that the company had made the declaration in the Return Form that no AR applied to it.
6. Hence it cannot be said that the decision by KPHDN not to apply the AR dated 13/9/2012 was illegal, irrational and unreasonable, but it was made lawfully and reasonably, in accordance with S138B of the ITA and the AR Rules.
7. The applicant had failed to show the existence of "exceptional circumstances" as mentioned above (point 2).The Court did not find any issue relating to "lack of jurisdiction" on the part of the respondent in refusing to apply the AR dated 13/9/2012.
8. All the assessments in dispute (for YA 2010, 2011 and 2012, all dated 19/9/2017) are under appeal to the SCIT by way of Form Q and the applicant should proceed with the appeal under S99 and not file for JR before this Court.

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