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Direct Taxation

TAX CASE UPDATE

Application for judicial review (JR)
DGIR's decision to subject payments for bareboat chartering to withholding tax.

ALWAN ENTERPRISE SDN BHD v KPHDN

High Court of Malaya in Kuala Lumpur
Application For Judicial Review No. WA-25-335-12/2015
Date of Judgment: 3 Oct 2018

Facts and Issues:

The applicant filed this application for JR in response to the DGIR's (respondent's) decision, which was conveyed to the applicant via 2 letters dated 8/10/2015 and 18/12/2015, that the applicant's payments to a company in Japan, Fukada Salvage & Marine Works Co. Ltd. (Fukada), under an agreement for bareboat charter, were subject to withholding tax (WHT) under S109B(1)(c) of the Income Tax Act 1967 (ITA). The application sought for (amongst others) an order to quash that decision, as well as a declaration that the DGIR's refusal to apply Article 8 of the Double Taxation Agreement between Malaysia and Japan ("the DTA") is inappropriate/ odd/ absurd/ and/or in breach of Article 96 of the Federal Constitution. *(All sections cited hereinafter are from the ITA unless otherwise stated.)*

The applicant is a Private Limited Company registered in Malaysia. Among its main activities is that of operating, maintaining and chartering of marine vessels. Under a bareboat chartering agreement signed between the applicant and Fukada, for a boat (which was later renamed '*Omni Taran*') for a period of 5 years, the applicant made payments to Fukuda for the years of assessment 2007 to 2010 which totalled RM31 million. Following a tax audit in 2014, the applicant was informed in a letter from the DGIR, that the payments of bareboat chartering to Fukuda fall within the special class of income under S4A(iii) which is subject to WHT under S109B(1)(c), and that under the DTA, they fall under royalty in Article 12. Furthermore, the DGIR also demanded payment of WHT with penalty for each of the years of assessment 2007 to 2010, which amounted in total to RM3.4 million.

After having its appeal against that decision rejected by the DGIR, the applicant proceeded to file for JR on 22/12/2015.

Decision:

The application was dismissed by the Court as it found no merit in the application. The Court declared it was in no position to ascertain the underlying facts, based simply on documents downloaded from the internet and the unreliable report from RAM Credit Information Sdn Bhd (tendered in Court by the applicant). The appeal should have been made to the Special Commissioners of Income Tax (SCIT) which is the proper forum to make findings of facts.

The grounds of the decision are summarized below:

1. The Court referred to Lord Diplock's classification of grounds of JR in *Council of Civil Service Unions v Minister for the Civil Service [1985]* which was adopted in a previous decided case[1]. They are – (i) illegality; (ii) irrationality; and (iii) procedural impropriety. In the present case, the applicant is relying only on the issue of illegality. The applicant submitted that the DGIR was wrong and committed an error in law which resulted in illegality when he decided that the payments to Fukada for bareboat chartering fall under Article 12 of the DTA, and did not take into account the following factors –

   (i) The exclusion clause which states that royalties under Article 12 of the DTA is exclusive from those set out in Article 8, and the said payments fall under Article 8 of the DTA;
   (ii) Any interpretation made (of the DTA) must be read together with the Commentary on Article 8 of the DTA by the OECD[2] model on which the DTA was modeled, and also followed by many other countries;
   (iii) Fukuda is an international shipping company which operates in international traffic and bareboat chartering is just an ancillary business and not its main business, and therefore Article 8 of the DTA applies.

2. The applicant contended that for the payments to Fukuda to fall under Article 8 of the DTA, it must establish the following facts pertaining to Fukuda:
   (i) It should not have a permanent establishment in Malaysia;
   (ii) It is an international shipping company carrying on its business in international water/ traffic;
   (iii) It is an enterprise engaged in the international operation of ships in the transportation of passengers and cargo;
   (iii) Its engagement in bareboat chartering is only an ancillary business.

   The applicant submitted that, based on evidence and documents from reliable websites produced in Court, all the above requirements have been established by the applicant, and the DGIR's contention that there is not enough evidence (to establish the facts) "*does not hold water*", as the respondent has not produced anything to disprove the information provided by the applicant.

3. However, the Court did not agree with the above submission and pointed out that it is trite law that the onus is on the taxpayer to demonstrate that the WHT should not have been imposed, and it is not the duty of the DGIR to disprove the taxpayer's case. (*Lower Perak Co-Operative Housing Society Bhd v KPHDN [1994] 2 MLJ 713*). The Court went on to review the source and contents of the documents produced as evidence in court and came to the conclusion that they were "*unreliable documents*" –

   " *In view of the unreliable documents, either downloaded from the internet or sourced from third parties, and the contradicting statements by both the applicant and the DGIR, this court cannot make a finding of fact that the payments arising from the agreement between the applicant and Fukuda on the bareboat chartering, falls under Article 8 or 12 of the Malaysia-Japan DTA.*"

4. Therefore, the Court is of the opinion that –

   "…*there must be an ascertainment of the underlying facts. Without a proper ascertainment and/or findings of the facts, this court cannot come to a definitive conclusion as to whether Article 8 or 12 is applicable in this factual situation*."

   On this basis, the matter should have been referred to the SCIT under S109H(1) as the SCIT are the judges of facts in tax matters. (*KPHDN v Mudah.My Sdn Bhd [2017] MLJU 162*.)

5. On the merits of the application itself, the Court referred to the case of *KPHDN v Teraju Sinar Sdn Bhd [2014] 4 MLJ 218* and declared that the decision in that case is binding. It was held in

that case, that the charging law is the ITA and not the DTA, which only determines the availability of relief from tax and that the party seeking relief from tax should be the non-resident in Malaysia. The following statement from that Case Judgment is highlighted:

> "*The starting point before relief is sought therefore remains, that is, the application of the charging provisions ss 4A and 15A. We hold that Teraju's liability from the failure, its failure to act under s 109B, attracted the operation of s 39(1)(j) and that it is not a matter involving the operation of the DTA*."

Applying the principle in Teraju's case, the DGIR is correct to demand payment of the WHT from the applicant. If Fukuda takes the position that its income is only taxable in Japan under the DTA, Fukuda must make the application to the DGIR. The statutory duty of the applicant is merely to withhold the tax portion of Fukuda and transmit the same to the DGIR.

Based on the above reasons, the Court found no merit in the application.

Notes:
1. Booi Kim Lee v YB Menteri Sumber Manusia & Golden Plus Geaniait SB [1999] 3 MLJ 515
2. Organization for Economic Corporation and Development

Members may read the full Grounds of Judgment at the websites of the Institute and the LHDNM.