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PREMIER TAX EVENT OF THE YEAR

NATIONAL TAX CONFERENCE 2020

25 & 26 AUGUST 2020 | TUESDAY & WEDNESDAY

VIA LIVE STREAMING

PREMIER TAX EVENT OF THE YEAR
NATIONAL TAX CONFERENCE 2020

Panel Member

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TOPIC 6:

FORUM — UPDATES OF TAX CASES

- Suing the Minister of Finance in Tax Matters
- Deductibility of payments/ contributions made by Developers and "fines and penalties"
- Civil recovery of taxes
- Advance Ruling – questionable future
- Tax authority – duty of care to taxpayer
- International Cases: "Shareholders Advances" and the Section 140A conundrum – are these loans to begin with?

SUING THE MINISTER OF FINANCE IN TAX MATTERS

- Are actions of the Minister of Finance amenable to judicial review in tax matters?

SOME GENERAL POWERS OF MoF

Section 135 of the Income Tax Act, 1967

"The Minister may give to the Director General directions of a general character (not inconsistent with this Act) as to the exercise of the functions of the Director General under this Act; and the Director General shall give effect to any directions so given."

Section 44 of the Real Property Gains Tax Act, 1976

"The Minister may give to the Director General directions of a general character (not inconsistent with this Act) as to the exercise of the functions of the Director General under this Act; and the Director General shall give effect to any directions so given."

MENTERI KEWANGAN MALAYSIA & KETUA PENGARAH KASTAM MALAYSIA V PENGERANG INDEPENDENT TERMINALS SDN BHD

W-01(A)-3155-06/2019

OVERVIEW

- MOF has control over the DG of Customs pursuant to section 5(1) of the Goods and Services Tax Act, 2014.

- Also, under the same Act, the Minister of Finance has the power to decide whether any particular supply of goods or services is or is not a zero-rated supply pursuant to paragraph 3(2) of the Zero-rated Supply Order, 2014.

- Having such power and control, the MOF instructed the DG of Customs to issue a bill of demand to the taxpayer to collect goods and services tax on the storage service that the taxpayer supplies, even though the service in question is a zero-rated supply.

Overview (cont.)

- In essence, storage of goods by a port operator or any person authorised by the Minister of Transport is a zero-rated supply under the Zero-rated Supply Order, 2014. Taxpayer is demonstrably both.
- Customs confirmed zero rating status. Later during an audit, non-compliance alleged.
- The taxpayer wrote to the Johor RMCD to explain that RMCD Headquarters had confirmed zero-rating. Subsequently, the taxpayer provided proof that the taxpayer is a port operator duly licensed and is also authorised by the Minister of Transport.
- Suddenly, some 16 months later, a bill of demand was issued.
- RMCD informed that the bill of demand was issued pursuant to directions from MOF via a letter.
- The taxpayer wrote to the MOF and DG of Customs to confirm that the MOF made a decision on this matter and not DG of Customs. The MOF and DG of Customs did not respond.

Overview (cont.)

- The taxpayer applied for judicial review of the decision of the MOF to direct the DG of Customs to issue the bill of demand. DG of Customs named as respondent as well.

- The DG of Customs alleged that the matter was referred to the MOF to "*mendapatkan pandangan*".

- Further, the DG of Customs argued that the power to recover goods and services tax lies with the DG of Customs and not the MOF. It was also argued that the taxpayer failed to appeal to the DG of Customs as soon as the bill of demand was issued, and subsequently, if the appeal was rejected, to appeal to the Goods and Services Tax Tribunal.

- The taxpayer contended that in no circumstances can the letter in question be reduced to some form of friendly conversation between the MOF and DG of Customs. This is particularly so given the express provisions of the Zero-rated Supply Order, 2015 and section 5(1) of the Goods and Services Tax Act, 2014, and the facts, events and actions by the MOF.

HC and COA decision

- The High Court dismissed the application by the taxpayer for leave to commence proceedings.

- On appeal, the Court of Appeal held that application for judicial review should be heard on its merits, in the context of the facts, events and actions by the MOF. The Court of Appeal remitted the matter back to the High Court for the High Court to hear the merits of the application for judicial review.

- High Court allowed the judicial review application on the merits of the case. Held that : (a) the Zero-rated Supply Order, 2014 clearly provides that storage service supplied by a port operator -or a person authorised by the Minister of Transport is a zero-rated supply, and a zero-rated supply is not taxable; (b) the taxpayer has fulfilled the requirements of the Zero-rated Supply Order, 2014, being a port operator and authorised by the Minister of Transport; and (c) consequently, the taxpayer's storage service is a zero-rated supply and not taxable.

- MOF and DG of Customs appealed to the COA. The appeal was dismissed.

Comments

- As most tax legislation gives the power to the Minister of Finance to control and direct the various revenue agencies, it is clear with this decision that the Minister of Finance cannot act with impunity when exercising such power and it is not an excuse for revenue agencies to carry out the instructions of the Minister of Finance where such actions do not accord with the law.

- There are also powers exercised directly and solely by MOF eg. remission and decisions on this are clearly subject to judicial review

DEDUCTIBILITY OF PAYMENST/CONTRIBUTIONS MADE BY DEVELOPERS AND "FINES AND PENALTIES"

- Current hot topic
- Are the payments/contributions wholly and exclusively incurred in the production of gross income?
- Position on deductibility of fines/penalties paid for "infringements" ?

Overview – Recent SCIT Decisions

Case	Type of Contribution	SCIT Decision
EASB v KPHDN	Contribution made to the *Lembaga Perumahan dan Hartanah Selangor* to exempt the taxpayer, as a property developer, from building lower cost units.	- It is **not a payment that is wholly and exclusively incurred in the production of the taxpayer's gross income**. The taxpayer made the contribution to release the taxpayer from the liability imposed by the State Government to build lower cost units, and to acquire the right to build and sell more expensive units. - There is **no provision in the ITA that directly or clearly allow the deduction** of the contribution. - Further, **the contribution is not to the detriment of the taxpayer.** The taxpayer has already received returns by developing more expensive units. If the taxpayer were allowed to make a claim for deduction, the taxpayer would at least double its profit. - Also, **the contribution is an aid or support to the State Government and is, therefore, voluntary**. The word 'contribution' means "*apa-apa yang diberikan sebagai bantuan atau sebagai sokongan*". - Furthermore, in terms of public interest, if the taxpayer were allowed to make a claim for deduction, **it encourages property developers to not build lower cost units**.

Overview – Recent SCIT Decisions (cont.)

Case	Type of Contribution	SCIT Decision
TESB v KPHDN	Contribution made by the taxpayer, as a property developer, to the *Lembaga Perumahan dan Hartanah Selangor* to reduce the Bumiputera sales quota.	- **The facts in this case and the case of Prima Nova Harta Development Sdn Bhd are the same**. The SCIT do not intend to have a different view or decision from that decided by the SCIT in the Prima Nova Harta Development case. - The **payment made by the taxpayer is the payment of a penalty or fine**. - The *Pekeliling Lembaga Perumahan dan Hartanah Selangor* states that (a) **a penalty or fine will be imposed for each unit sold before approval is granted**; **AND** (b) **an amount equivalent to 10% of the Bumiputera discount will need to be paid for each unit released**. - The word **'and' means that both are a penalty and fine**. - Even though no evidence was adduced to show that the taxpayer had made a sale before the approval was granted, **based on the payment made by the taxpayer, which consisted of an amount equivalent to 10% of the Bumiputera discount plus 5%, on a high probability, the taxpayer had made the sale before the approval was given**.

Overview – Recent SCIT Decisions (cont.)

Case	Type of Contribution	SCIT Decision
		- Since the payment made by the taxpayer is a penalty or fine, **it is not wholly and exclusively incurred in the production of the taxpayer's gross income** . - Further, **the taxpayer has already received returns by being given the quota release**. - Also, **if the taxpayer were allowed to make a claim for deduction, the taxpayer would at least double its profit**, firstly, through sales to non-Bumiputeras at full price, and secondly, through the deduction. - Furthermore, in terms of public interest, if the taxpayer were allowed to make a claim for deduction, **property developers would be more inclined to make the payment, knowing that they will get double the profit**

PRIMA NOVA HARTA DEVELOPMENT SDN BHD V KETUA PENGARAH HASIL DALAM NEGERI

WA-14-7-12/2019 (HIGH COURT)

OVERVIEW

- The taxpayer, a property developer, like many other property developers, are required to sell certain units to Bumiputeras.

- Due to market conditions, not all units that are allocated for Bumiputeras could be sold to Bumiputeras. So, the taxpayer applied for permission from the State Government to sell the Bumiputera units to non-Bumiputeras.

- A payment must be made to the State Government, consisting of an amount equivalent to 7% of the Bumiputera discount plus 5% *denda*. However, the State Government waived the 5% *denda* in this case.

Overview (cont.)

- The contention of the Inland Revenue Board is that the payment is a penalty and that penalties cannot be deducted.
- It is the taxpayer's position that this payment is a cost incurred in doing business.
- Further, it is the taxpayer's position that a penalty is imposed if there is a transgression of the law. Here, the taxpayer obtained permission to sell to non-Bumiputeras so there is no transgression of the law. The issue of penalty does not arise.

Overview (cont.)

High Court's Decision

- The payment is not a penalty.

- The taxpayer is allowed to sell the Bumiputera units to non-Bumiputeras provided that an amount equivalent to 7% of the Bumiputera discount is paid to the State Government. With the sale of the Bumiputera units to non-Bumiputeras, it has generated income. If not, there is no income at all. In the circumstances, the payment is wholly and exclusively incurred in the production of the taxpayer's gross income.

- The payment made should be considered as a whole. The payment is exclusively related to business operations, in order to generate income, and can be deducted.

Comments

- These payments are directly related to business. The connection between the payments and business is clear.

- Consider the different types of payments eg. release of bumi units, release of low cost housing requirements, contributions to state government. How does Prima Nova impact the IRB's position on all of this?

- There are numerous case law authorities that recognise that a payment made to remove an obstacle to profitable trading or that result in the increase of income is attributable to revenue **(INLAND REVENUE V CARRON COMPANY 1968 SC(HL) 47; KULIM RUBBER PLANTATIONS LTD; ANGLO-PERSIAN OIL CO, LTD V DALE [1932] 1 KB 124).**

Comments (cont.)

- When it comes to the 5% *denda*, the language used is not necessarily to be adopted as conclusive proof (**INLAND REVENUE COMMISSIONERS V WESLEYAN AND GENERAL ASSURANCE SOCIETY [1946] 2 All ER 749**).

- In essence, a penalty is imposed: (a) under some statutory provision; (b) when a wrongdoing has been committed; and (c) in order to punish the wrongdoer.

- The 5% is not imposed in order to punish a wrongdoer. Typically, without making the payment, the Bumiputera units cannot not be transferred. Because of this, there can never be a breach. Property developers have to pay first.

- Further, even if the 5% is a penalty, the ITA does not specifically provide that a penalty is not a deductible expense under the ITA. There are no express words to that effect in section 33(1).

Comments (cont.)

- Why shouldn't a levy, fine or penalty be disallowed if it is part of day to day operations and made to realise income. For courts to intervene in the name of public policy would only introduce uncertainty - **BRITISH COLUMBIA LTD. V. CANADA, [1999] 3 S.C.R. 804**

- Parliament has expressly disallowed the deduction of certain expenses under section 39(1) of the ITA. Nothing in section 39(1) applies to disallow the deduction of the payments. If Parliament had wished to limit the deduction of a penalty, Parliament would have done so expressly.

CIVIL RECOVERY OF TAXES

- Pay first and appeal later?
- Summary judgment or full trial?

GOVERNMENT OF MALAYSIA V MOHD NAJIB BIN HAJI ABD RAZAK

(2020) MSTC 30-401

OVERVIEW

- The Government of Malaysia filed an application against the taxpayer for a summary judgment under order 14 rule 1 of the Rules of Court 2012 to recover additional income tax.
- The Defendant had filed an appeal to the Special Commissioners of Income Tax ("SCIT").
- The Plaintiff argued that a summary judgment has to be entered against the Defendant as it is a clear-cut case and that the Defendant had failed to pay the outstanding sum within the prescribed time resulting in penalties under section 106(5) and 106(6) of the ITA.

High Court's Decision

- The High Court held that the case should be heard by the SCIT as it involved questions of fact, including the issue as to whether the income received by the Defendant was a donation or the Defendant's own income.

- The additional income tax were due and recoverable as debt due to the Plaintiff by virtue of section 106 of the ITA as decided by cases. The certificate signed by the Director General is prima facie evidence that the amount claimed by the Plaintiff was the amount due. The Court upheld the "pay first talk later" expression.

- The taxpayer's rights are protected under section 99 of the ITA which allows the taxpayer to appeal before the SCIT and if the taxpayer is dissatisfied, then he might appeal to the Court against the decision of the SCIT.

- An application for a stay of proceedings pending an appeal on the tax assessment was dismissed by the High Court on 28 February, 2020. A stay of proceedings or execution will only be granted where the court is satisfied that there is special circumstances.

KERAJAAN MALAYSIA V ISB

OVERVIEW

- This is an RPGT vs income tax case. IRB commenced civil recovery and sought summary judgement.
- The taxpayer had filed an RPGT return in respect of a JV transaction that the taxpayer entered into (as the landowner) with a developer.
- IRB decided to regard the taxpayer as conducting a business of selling property and raised income tax assessments against the taxpayer.

Overview (cont.)

- The taxpayer opposed the summary judgment application on the grounds that there were triable issues, namely:
  - Whether the assessments are null and void – IRB did not indicate which particular provision of the ITA the taxpayer is liable to be taxed under; and
  - Whether the assessments are time barred – the IRB had not alleged that any of the exceptions to the time bar applies.
- The taxpayer argued that section 106(3) of the ITA is not applicable here as the taxpayer is not entering any plea that the amount of tax is "excessive" or "incorrectly assessed". Instead, the taxpayer is questioning the legality of the assessment.

Overview (cont.)

- The taxpayer also pointed out that there was irregularity in the certificate under section 142(1) of the ITA that the Government adduced. The certificate was exhibited to the Government's Affidavit in Support of the application for summary judgment. However, the certificate was dated later than the date on which the affidavit was affirmed.

- The taxpayer argued that section 106(3) of the ITA is not applicable here as the taxpayer is not entering any plea that the amount of tax is "excessive" or "incorrectly assessed". Instead, the taxpayer is questioning the legality of the assessment.

Overview (cont.)
High Court's Decision

- The High Court held that there are triable issues in this case and dismissed the application for summary judgment. There seems to be uncertainty on which section of the ITA the IRB is relying on to tax the taxpayer. Further, the Plaintiff has to prove that there has been fraud, wilful default or negligence on the part of the taxpayer.

- It was also held that these triable issues are not on quantum but on whether or not the IRB has the power to raise the assessments.

- The parties eventually entered into a consent judgment recording that there will be a standover of payment of the taxes till the Form Q appeals are finally disposed.

Comment

- The substantive issue in the case are equally interesting.

- It's an issue of when a landowner enters into a JV with a developer and gets entitlement units, whether this is subject to income tax or real property gains tax. Some of the issues are :-

  (i) Whether the deemed disposal for RPGT purposes can be a sale for ITA purposes.
  (ii) What income is produced and how is it to be calculated?
  (iii) Can IRB assess the purported gain only after invoking Section 140?

- A decision is due to be made by the SCIT this Friday

ADVANCE RULING – QUESTIONABLE FUTURE

Are advance rulings amenable to Judicial Review?

National Tax Conference (NTC) 2020, 25 & 26 August 2020
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IBM MALAYSIA SDN BHD v KETUA PENGARAH HASIL DALAM NEGERI W-01(A)-294-04/2018

OVERVIEW

- The taxpayer intended to execute an agreement. The taxpayer made an application for advance ruling through its tax agents.
- The IRB issued an advance ruling which was not favourable to the taxpayer
- .
- The taxpayer brought judicial review proceedings to challenge the advance ruling.
- The High Court decided that the advance ruling is amenable to judicial review.

Overview (cont.)
Court of Appeal & Federal Court Decision

- The Court of Appeal overturned the High Court's decision.
- The Court of Appeal took the view that the taxpayer had a choice whether or not to be bound by the advance ruling.
- The taxpayer's appeal to the Federal Court was dismissed. The Federal Court held that an advance ruling is not a decision amenable to judicial review.

Comment

Given the decision in the IBM case as well as the implication from the earlier SKF Bearing Industries (Malaysia) Sdn Bhd case (where the IRB refused to follow an advance ruling and said they are not bound by it), one should seriously consider when, if ever, should an advance ruling application be made

Tax authority – the duty of care to taxpayers

National Tax Conference (NTC) 2020, 25 & 26 August 2020
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HORMAT MULIA HOLDINGS V KERAJAAN MALAYSIA AND LEMBAGA HASIL DALAM NEGERI (NO. 21NCVC-59-07/2016)

OVERVIEW

- An action in the tort of negligence and defamation was brought by a taxpayer against the IRB in relation to a winding-up petition.
- In this case, a judgment in default was entered against the taxpayer and a settlement of judgment by way of 12 instalment payments was entered between the taxpayer and the IRB.
- Upon acceptance of the proposal, the taxpayer made instalment payments. However, subsequently, there was a winding-up petition against the taxpayer, which was advertised in local newspapers and gazette. The petition was a mistake and was subsequently withdrawn.

Overview (cont.)

- The High Court was of the view that there existed no duty of care by the IRB to the taxpayer such as could afford the taxpayer a cause of action in negligence upon the basis pleaded by the taxpayer. It would not be just and equitable for there to be a duty of care between litigants.

- Even if the winding up petition was not withdrawn by the IRB, surely the taxpayer would have been in a position to resist it. The petition would not have been sustainable on its merits. The danger of discouraging an honest claim for fear that should it fail, an action in negligence might be brought is a compelling reason why it would not be just and reasonable to impose a duty of care between litigants. Where there is malice or abuse in commencing legal proceedings, there exist actionable torts that would compensate for any damage caused.

- The taxpayer also has not proved that it suffered any damage by reason of the winding up petition being presented. The IRB not only withdrew the petition, the IRB also wrote a letter acknowledging that the petition was presented by mistake. If any of the taxpayer's clients required explanation, it would have been easy enough to demonstrate that the petition was presented by mistake and withdrawn.

Overview (cont.)

- The High Court also found that the advertisements of the winding up petition was not defamatory. All that was disclosed in the advertisements was the fact that a petition had been presented against the taxpayer and the date that it was to be heard. It would be clear to any reasonable man that whether the petition presented was maintainable was still left to be determined by the Court.

GORDON Et Al v The Queen (2019 FC 853)

OVERVIEW

- The plaintiffs were chartered accountants and accounting firm.
- The CRA investigated the plaintiffs which resulted in the indictment and prosecution of the plaintiffs on fraud, attempted fraud and possession of proceeds of crime.
- The Crown stayed the charges after a few years.
- The plaintiffs sought damages from the Government of Canada premised on tort arising from inter alia an negligent investigation.

Overview (cont.)

- The Federal Court of Canada examined the issue of whether the CRA owes taxpayers a duty of care.

- The appeal was ultimately unsuccessful – "*On my assessment of the evidence, the CRA had reasonable and probable grounds for recommending a prosecution. There is no evidence that CRA officials acted unlawfully, maliciously or negligently in the conduct of the JAD investigation. To the contrary, the investigation was thorough, fair, objective and competently carried out. These actions are accordingly dismissed*"

- The Court however clearly found that there is the existence of a duty of care for CRA when conducting the investigation which was not a routine audit.

- The finding that there is a duty of care is in line with the decision in **LEROUX V CANADA REVENUE AGENCY [2014] BCJ NO 780**.

Comments

- In Leroux, the taxpayer sued the CRA for negligence and alleged that its abusive audits and proceedings has caused him financial ruin, loss of business, loss of home and deterioration of health. Although the case was ultimately dismissed, it is noteworthy that the Court found that the CRA auditors owed the taxpayer a duty of care and that the applicable standard was one of a "*reasonably competent tax auditor in the circumstances*". "*A prima facie duty of care was established by the specific proximity of the parties and the imposition of large penalties by the defendants. There were also no policy reasons to negate the duty of care owed by the auditors to the plaintiff*"

- The Court held that the auditors had breached this duty when they unjustifiably re-opened the taxpayers statute-barred years and assessed penalties with daily compound against him. The auditors had also act as though the duty was on the taxpayer to prove that he was not grossly negligent, which is contrary to the relevant act.

- The case was dismissed on the basis of causation, the taxpayer failed to prove that the breach by the auditors had caused him the damages claimed.

International Cases "Shareholders Advances" and the Section 140A conundrum – are these loans to begin with ?

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LOTTERIES PTY LTD v UMBRELLA ENTERPRISES PTY LTD (in liq) [2014] VSC 605, BC201410283

Advances to be considered as funding of capital or loan?

OVERVIEW

- There was a joint-venture type of arrangement between 2 individuals, whereby 1 of them would fund a café and the other would manage and operate the said café, in order to secure steady earnings in view to sell the café. The funder would be paid back his investments as first call on the proceeds of the sale.
- When the business was sold at a loss and below the amount of contribution made by the funder, the funder asserts that the advance made by him was a loan and as there was no date fixed for repayment, it was repayable on demand.

Overview (cont.)

Supreme Court of Victoria's Decision

- The Court, held that it was not a loan repayable on demand and it was not even a loan. It had none of the incidents of a loan. The Court, in deciding whether the advance were a loan or a capital contribution, look at the following factors:

a. The intentions of the parties;
b. The terms of the agreement;
c. An objective analysis of the advance; and
d. Commercial considerations.

- It is noteworthy that the court look at the commercial realities of the transaction between the parties and held if it were a loan, it would be fundamentally inconsistent with the nature of this venture.

Comments (cont.)

- The distinction made between a loan and capital contribution has also been similarly made in the case of **Kellar v Williams [2000] 2 B.C.L.C. 390**. In this case, the Privy Council held that a particular advance made by the Appellant was a non-repayable capital contribution rather than a loan.

- Briefly, the Appellant and Respondent entered into an agreement to form a company whereby the terms of the agreement was that the Appellant was to provide funds to the company. It was however unclear whether the advance is to be treated as a loan or capital contribution. When the Company went through liquidation, the question was whether the funds provided by the Appellant were a loan or capital contribution. If it was the latter, any money left after the payment will be payable to the shareholders of the company.

Comments (cont.)

- The US Courts, more recently in the case of ***Povolny Group, Inc v. Commissioner, T.C. Memo 2018-37***, are guided by a few non-exclusive factors called the "Mixon factors" which includes *inter alia* the following:

  a. The presence or absence of a fixed maturity date.

  b. The source of payments.

  c. Whether the lender has the right to enforce payment.

  d. Whether the lender gains more right in participation of management.

  e. The source of interest payment.

  f. The ability of the borrower to secure funds form outside financial institutions.

THANK YOU

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