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TECHNICAL

Direct Taxation

TAX CASE UPDATE

Withholding tax under Section 109B of Income Tax Act, 1967 (ITA)

Whether payments of charter fees for the time charter of ships and crews to non-resident (NR) companies are subject to withholding tax under S.109B of ITA.

Federal Court of Malaysia [Civil Appeal No: 01(f)-23-09/2012(W)]

Lembaga Hasil Dalam Negeri v Alam Maritim Sdn Bhd

Date of Judgment: 17 October 2013

Facts

This is an appeal against the Court of Appeal's decision to uphold the decision of the High Court which had granted the taxpayer's (Respondent) application for a judicial review to quash by certiorari a decision of the Director General of Inland Revenue (DGIR).

The Respondent is a private company resident in Malaysia with its main activity being the owning of vessels, hiring and managing vessels with third party charterers. Between 1998 and 2004, the Respondent made payments for the hire of vessels, services and crews under "Uniform Time Charter Party for Offshore Service Vessels" contracts (UTC) to NR companies particularly from Singapore. These payments were made without deducting withholding tax under S.109B of the ITA. It was not disputed that the recipients were NR companies from countries that had entered into double taxation treaties with Malaysia and have no permanent establishments (PE) in Malaysia. Also undisputed was the fact that the payments were charter fees for the time charter of ships and crews, and received as income by the NR companies. Prior to this appeal, the High Court and Court of Appeal had concluded that the income of the NR companies derived from the UTC was business income.

The Appellant's stand on this issue was that the payments made by the Respondent were "a special class of income under S.4A(iii) of the Act" (ITA) and as such, "the avoidance of double taxation agreement (DTA) afforded no relief to the respondent." This position was communicated to the Respondent as a private ruling on 7.7.2005 and by letter on 21.5.2007.

Being dissatisfied with the Appellant's decision, the Respondent filed an application to the **High Court** to quash the Appellant's decision on the basis that the charter fees paid by the Respondent were "business income" of the NR companies. As the recipients were without PE in Malaysia, such income is not taxable, hence relieving the Respondent of the duty of deducting withholding tax. The High Court quashed the Appellant's decision and in doing so, adjudged that the maintenance of a PE in Malaysia was a key factor in deciding whether the income of the Singapore enterprise was to be taxable or not in Malaysia.

The Appellant then filed an appeal to the **Court of Appeal** against the High Court's decision. The Court of Appeal affirmed the High Court's decision and stated that as the NR companies did not

have any PE in Malaysia, relief from taxation was afforded to them, and under Article IV of the DTA the Respondent was relieved of any responsibility to withhold tax. It also opined that the provisions of these treaties took precedence over the ITA.

Issue

Whether the time charter payment made by a resident company in Malaysia to NR companies in Singapore is subject to withholding tax under S.109B(1) of the ITA read together with S.4A (iii) and S.24(8) of the ITA and therefore, such NR companies are not entitled for relief under Article IV of the DTA between Malaysia and Singapore.

Decision

Appeal allowed. The Orders of the High Court and Court of Appeal are set aside.

The following are some salient points from the judgment:

1. When interpreting provisions of a taxing Act the intention of Parliament must be construed from the language used and it is for the Court to interpret it accordingly. If the words are not so explicit, it is incumbent upon the court to undertake an exercise to seek out the purpose of Parliament. The adoption of the "purposive approach" in the following cases was highlighted:

   - *AG v Carlton Bank [1899] 2 QB 158*
   - *WT Ramsay Ltd v Inland Revenue Commission [1982] AC 300*
   - *Pepper (Inspector of Taxes) v Hart [1993] AC 59*
   - *Palm Oil Research and Development Board Malaysia & Anor v Premium Vegetable Oils Sdn Bhd [2004] 2 CLJ265*

2. S.4 of the ITA lays out the classes of income on which tax is chargeable, and imposes tax even on any NR company unless relief is granted by a DTA. The charging law is the ITA and not the DTA. The DTA is merely the mechanism to eliminate double taxation and grant relief and has no jurisdiction as regards the imposition or creation of tax (*Walter Wright (Singapore) Pte Ltd v Director General of Inland Revenue [1990] 2 MTC 115).* Article IV of the DTA with Singapore grants conditional relief to income falling under S.4 of the ITA, but subject to the NR companies establishing the absence of PE in Malaysia.

3. However, change came about with the creation of a "*special class of income*" under S.4A of the ITA (effective from 30.12.1983) "whereupon the income of non-residents derived from certain sources, which include rent or other payments made under any agreement or arrangement for the use of moveable property, derived from Malaysia would be chargeable to tax." Article VI of the DTA with Singapore (which begins with the phrase '*Notwithstanding the provisions of*….') that relates to the taxation of income from the operation of ships or aircraft in international traffic, "takes prominence over Article IV, thus entitling the Malaysian government to tax NR companies subject to given conditions."

4. With the income of the NR in the circumstances of this case falling under S.4A (iii) and dealt with differently by the ITA and the DTA, Article IV is inapplicable to the instant facts.

5. It is the Court's findings that:
   - S.4A (iii) of the ITA, read together with Articles II and VI of the DTA empowers the Government of Malaysia to tax a NR company's income categorized as *special classes of*

income, "without the previous fear of the specter of a PE having been established in Malaysia." In construing the relevant provisions of legislation, the Court did not "find anything unjust or absurd in the purpose of Parliament".

- Payments were made by the Respondent under UTC, with the income received by NR companies as *special classes of income.* As it was the intention of Parliament to tax NR companies from Singapore in the circumstances of the case, and with Article IV being inapplicable to income received under S.4A(iii), the payments received by the non-residents were therefore taxable.

- It was incorrect for the High Court and Court of Appeal to take the simplistic approach of considering Article IV in isolation, giving undue significance to the existence or non-existence of a PE (*Hock Heng Company Sdn Bhd v DGIR [1979] 2 MLJ 51*), and giving no weight to S.4A(iii) of the ITA.

- As the NR companies in this appeal are taxable, S109B of the ITA is triggered, and the Respondent is statutorily bound to withhold a portion of the payments as tax.