
TECHNICAL

TAX CASE UPDATE

Appeal against judicial review -- payments to a non-resident treated as royalty subject to withholding tax.

[Director General of Inland Revenue v Alcatel-Lucent Malaysia Sdn Bhd & Alcanet International Asia Pacific Pte. Ltd.](#) (Court of Appeal) 2015

Civil Appeal No. W-01-428 2010

Date of Judgment: 29 September 2015

Facts & Findings:

The 2nd respondent, Alcanet International Asia Pacific Pte. Ltd. (AIAP) was a non-resident. By a service agreement dated 1.1.2003, AIAP agreed to allow the 1st respondent, Alcatel-Lucent Malaysia Sdn Bhd (ALM) to have connection to its data traffic and to access the global services provided by AIAP subject to payments at a fixed rate. Payments were made by ALM to AIAP for services provided by the latter without remitting WHT under [S109](#) of the ITA. ALM was of the view that [S109](#) was not applicable as the payments were for services performed outside Malaysia and all the servers for the network were located outside Malaysia.

After a WHT audit by the appellant, ALM was informed in 2007 that WHT was required to be paid on payments to AIAP for the years of assessment 2001 – 2005, which the appellant had treated as royalty and as such, subject to WHT under [S109](#) and/or [S109B](#) of the ITA.

According to the appellant's letter dated 14.4.2008, WHT was payable on payments to AIAP classified under the following headings:

1. Perbelanjaan SAP License and Maintenance Fees
2. Perbelanjaan Utilities – Leased Communications Facilities;
3. Bayaran Pelbagai kepada Pegawai Latihan, Pekerja Luar Malaysia dan sebagainya.

The amount required to be paid finally arrived at (after negotiations between the appellant and ALM) was RM1,507,674.80, which included increased WHT payable under either [S109\(2\)](#) or [S109B\(2\)](#) of the ITA. ALM then sought clarification from the appellant as to which WHT provision applied to the specific payments (listed above). However, in his reply, the appellant did not state which WHT provision applied to each specific payment, but insisted that WHT must be paid. ALM then paid the WHT under protest and proceeded to challenge the appellant's decision by way of judicial review.

In the application for judicial review made jointly by ALM and AIAP to the **High Court**, they sought (amongst others) the following reliefs:

- a. An Order of Certiorari to quash the appellant's decision contained in his letter dated 14.4.2008, that payments listed under the heading "*Perbelanjaan Utilities – Leased Communications Facilities*" are subject to WHT under S4A and [S109B](#) and/ or [S109](#) of the ITA and are further subject to increased WHT under [S109B\(2\)](#) and/or [S109\(2\)](#) of the ITA.
- b. A Declaration that the appellant's decision is erroneous in law and the payments are not subject to WHT or increased WHT under the relevant provisions (as stated above).

- c. An Order of Mandamus to compel the appellant to refund to ALM the WHT and increased WHT in respect of the above mentioned payments (in the sum of RM1,200,806) which ALM had paid under protest.

The reliefs sought for are based on the grounds that the appellant had acted in excess of and/ or without jurisdiction or unreasonably in that he:

- a. failed to exercise his statutory power fairly and in accordance with the rules of natural justice;
- b. failed to take into account relevant considerations;
- c. took into account irrelevant considerations;
- d. acted in excess of the jurisdiction and/or powers under the ITA;
- e. had abused and/ or misused and/or failed to use discretion;
- f. failed to give any basis or reasons as to why the payment for the services were subject to WHT.

High Court Decision:

The **High Court** allowed the respondent's application for judicial review and further held that the payments for the services were not royalty and therefore not subject to WHT. Among the grounds for the decision are the following:

- a. A perusal of the DGIR's letters submitted in evidence showed that both sections [109](#) and [109B](#) were mentioned. The court agreed that the 2 sections refer to two different scenarios for imposing WHT. It was unreasonable for the DGIR to apply both [109](#) and [S109B](#). This rendered the DGIR's decision unreasonable.
- b. The DGIR relied on an incorrect basis of fact since he had relied on an unsigned draft agreement (submitted in evidence) which related to other years of assessment to support the contention that the payments were subject to WHT by virtue of being royalty payments. As such the DGIR's decision was "*fundamentally flawed*."
- c. In deliberating on the meaning of "royalty", the case of Queen v St John Shipbuilding & Dry Dock Co. Ltd [1981] 1 F.C 334 was cited, wherein it was stated that "royalties".... "*when used in the sense of a payment for the use of property, connotes a payment calculated by reference to the use or to the production of revenue or profits from the use of the rights granted.*" In the present case there was no evidence to show that the Service Agreement was entered into by ALM and AIAP with the intention of allowing the use of software by ALM to produce profits. A perusal of the Agreement showed that it was an agreement by which AIAP agreed to provide services to ALM to facilitate access to the global network for voice, data and video communication to enable ALM to connect to the worldwide telecommunication network. There was no evidence that the payments were made for the grant of rights by AIAP to ALM to develop commercially or exploit the software. Hence, the High Court agreed that the DGIR erred in concluding that the payments were royalties, and in its view, that decision by the DGIR was one that no reasonable decision-maker in similar circumstances would have come to.

Hence, the DGIR's present appeal to the Court of Appeal (the Court).

Issue:

Whether the decision of the Director General of Inland Revenue (DGIR) in treating payments made by the 1st respondent to the 2nd respondent, in consideration of certain services provided by the latter, as royalty which is subject to withholding tax (WHT) payments under [S109](#) and/or

[S109B](#) of the Income Tax Act 1967 (the ITA) is liable to be quashed by way of judicial review.

Decision:

Appeal dismissed. The following is a summary of the grounds of judgment:

1. There are ample authorities that where a public decision maker fails to provide reasons, the courts are at liberty to conclude that he has no good reasons in making his decision. In the judgment of the Federal Court in Pahang South Union Omnibus Co. Bhd. v Minister of Labour and Manpower & Anor [1981] 2 MLJ 202, it was stated:

"In exercising these powers, the courts will take into account any reasons which the (decision-making) body may give for its decision. If it gives no reasons – in a case when it may reasonably be expected to do so, the courts may infer that it has no good reason for reaching its conclusion and act accordingly."

2. The appellant submitted that the payments in question fell within the meaning of "royalty" in [S2](#) of the ITA. However, the respondents contended that it was wrong to treat the payments for services relating to leased communication facilities as royalties when they were paid to a non-resident for services performed outside Malaysia. The respondents also claimed that the first time that the appellant disclosed to them that the payments were treated as royalty was on 15.6.2009 after they had filed the application for judicial review. Prior to that, the word "royalty" was never stated in any of the appellant's letters requiring ALM to pay WHT. It was submitted that the appellants had relied on both sections 109 and 109B because he was unsure and could not make up his mind which section applied.
3. Although both sides had submitted at length as to whether the payments in question were "royalty", it was noted by the Court that the present appeal arose from the respondent's application for judicial review to (amongst others) quash the DGIR's decision to treat the payments as royalties subject to WHT. There is a distinction between judicial review and appeal. Appeal is concerned with the merits of the case, in the sense that the appellate court can substitute its own opinion for that of the decision maker. Appeal lie on fact and law. Review, by contrast is not concerned with the merits of the decision but with the validity of the decision making process. After citing various cases, the Court made the following points relating to judicial review:

- a. Inland Revenue was not immune from the process of judicial review;
- b. A taxpayer could seek judicial review if he can show that the revenue had either failed in a statutory duty toward him, or had taken action which was an abuse of power or outside their powers altogether;
- c. For the purpose of judicial review, abuse of power included unfair exercise of a statutory power (quoting Lord Templeton in Preston v Inland Revenue Commissioners [1985] 2 all E.R. 327):

"Judicial review is available where a decision-making authority exceeds its powers, commits an error of law, commits a breach of natural justice, reaches a decision which no reasonable tribunal could have reached or abuses its powers."

4. The Court agreed with the grounds of the High Court decision that in the circumstances of the case, the DGIR had acted unreasonably by invoking both sections [109](#) and [109B](#) of the ITA in deciding that the payments were royalty as defined in [S2](#) of the ITA, and he had taken into consideration irrelevant matters by relying on the unsigned draft agreement in arriving at his decision.

5. Before the Court, Revenue unequivocally contended that the payments were in fact and in law, royalty which is subject to WHT under [S109](#) of the ITA. That was an implied admission that the payments were not chargeable to WHT under [S109B](#) of the ITA. In the Court's opinion, the DGIR had not only acted unreasonably in the circumstances of the case, but had committed an error of law and exceeded his statutory power by relying on both sections of the ITA. This was evidenced by the letter from Revenue dated 14.4.2008, which showed that the appellant was indeed indecisive with regard to which section applied to the payments in question.
6. Any doubts as to the applicable provision of the taxing statute must be held in favour of the taxpayer. (Commissioners of Inland Revenue v Angus [1889] LR 23 QBD 579; National Land Finance Cooperative Society Ltd v DGIR [1994] 1 MLJ 99)
7. The appellant admitted in its affidavit that his decision was based on the "Customer Services Contract" (submitted in evidence) which was an unsigned draft agreement for services provided by AIAP for the years prior to 2001 – 2005. That was irrelevant and cannot form the basis of the appellant's decision. A decision of an inferior tribunal which took into consideration irrelevant matters or disregarded relevant matters is amenable to judicial review and liable to be set aside.
8. Based on the above grounds, the appeal was dismissed. In view of that decision it was not necessary for the Court to decide whether the payments fell within the meaning of royalty under [S2](#) of the ITA.

Members may read the full [Grounds of Judgment](#) from the Official website of the Office of Chief Registrar, Federal Court of Malaysia.

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