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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.

IN THE FEDERAL COURT OF MALAYSIA
(APPELLATE JURISDICTION)
CIVIL APPEAL NO: 01(f)-23-09/2012(W)

BETWEEN

LEMBAGA HASIL DALAM NEGERI MALAYSIA **...APPELLANT**

AND

ALAM MARITIM SDN BHD **...RESPONDENT**

In the Court of Appeal of Malaysia
(Appellate Jurisdiction)
Civil Appeal No: W-01-268-2010

Between

Lembaga Hasil Dalam Negeri Malaysia ...Appellant

And

Alam Maritim Sdn Bhd ...Respondent

Coram:

HASHIM YUSOFF, FCJ
SURIYADI HALIM OMAR, FCJ
AHMAD HAJI MAAROP, FCJ
ZAINUN ALI, FCJ
JEFFREY TAN, FCJ

JUDGMENT OF THE COURT

Lembaga Hasil Dalam Negeri Malaysia i.e. the appellant made a decision vide a letter dated 21.5.2007 stating that

pursuant to section 109B of the Income Tax Act 1967 (the Act), the respondent was required to withhold tax on payment of charter fees made by it to non-resident companies, which had no permanent establishment in Malaysia. Being dissatisfied with that decision the respondent filed at the High Court of Malaya for a judicial review to have that decision quashed by certiorari. It was successful, and the appellant being dissatisfied filed an appeal at the Court of Appeal but failed. The appellant then filed a successful leave application before us on the following question:

> *'Whether the time charter payment made by a resident company in Malaysia to non-resident companies in Singapore is subject to withholding tax under subsection 109B(1) of Income Tax Act 1967 ("the Act") read together with subsection 4A(iii) and 24(8) of the Act and therefore, such non-resident companies are not entitled for relief under Article IV of the Agreement For the Avoidance of Double Taxation and the Prevention of Fiscal*

Evasion with Respect to Taxes on Income (Malaysia-Singapore) ("DTA").'

Background facts

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 e.g. Petroliam Nasional Berhad. In the year of 1998 up to 2004 (the said period), being the period of the matter of the application for certiorari granted by the High Court, the respondent entered into "Uniform Time Charter Party for Offshore Service Vessels" contracts (UTC) with non-resident companies particularly from Singapore. These non-resident companies hired out vessels, services and crews to the respondent, and in consideration payments were made to them under the said UTC contracts. In the belief that these non-resident companies were in receipt of business income and being only subjected to Singapore laws (and covered by the avoidance of double taxation treaties), the respondent made full payment without any deduction of withholding tax

under s. 109B of the Act. This section provides for the statutory deduction of tax from payments made to non-residents for services rendered (the provision will be reproduced later when we discuss the question for our determination in depth).

There are certain indisputable facts in this appeal, amongst them being the want of dispute as to the status of the non-resident companies, the non-resident companies being from countries that have entered into double taxation treaties with Malaysia and having no permanent establishments in Malaysia (with the majority being from Singapore i.e. 17 out of 22 companies). Further, parties are on common ground that the payments received by the non-resident companies from the respondent were charter fees for the time charter of ships and crews, and received as income by the non-resident companies. The tax to be withheld by the respondent was not that of the respondent's but of the recipient non-resident companies. It is indisputable that the High Court and the Court of Appeal concluded that the income of the non-resident companies derived from the

charter hire of vessels and crew contracts was business income.

We now touch on the antecedents which led to this appeal. Being desirous of listing the respondent company with Bursa Malaysia, and to avoid hiccups and pitfalls later, the respondent's technical adviser on 16.5.2005 applied for a private ruling from the appellant's Technical Department regarding the payments made to non-resident companies without any deduction of tax. The respondent simply wanted to know whether it had acted correctly. Vide letter dated 7.7.2005, the appellant's technical department supplied its opinion namely, i.e. in the circumstances of the case, the charter fees payments were subject to withholding tax. The reply (exhibit AM-6) in clear terms stated as follows:

> *"2. Sila maklum selepas meneliti hujah-hujah yang dikemukakan oleh tuan, Bahagian ini berpendapat bayaran 'charter fees' kepada syarikat-syarikat tidak bermastautin adalah*

pendapatan kelas khas di bawah subseksyen 4a (iii) ACP. Oleh yang demikian bayaran ini adalah tertakluk kepada cukai pegangan di bawah seksyen 109B."

On 16.8.2005 the respondent's solicitor brought up the matter again, and submitted a request to the appellant for a decision on the withholding of such tax. On 21.5.2007 the appellant reiterated its stand as per the earlier letter dated 7.7.2005, in that pursuant to section 109B of the Act, the respondent was required to withhold tax on the payment of charter fees made by the respondent for the said period to non-resident companies operating the business of supplying ships, crew or time charter of ships and crew (time charter services). It was the submission of the appellant that as those payments were *a special class of income* under section 4A (iii) of the Act the avoidance of double taxation agreement (DTA) afforded no relief to the respondent.

Dissatisfied with the appellant's reply, the respondent filed an application at the High Court under Order 53 Rules of

the High Court 1980 to quash the appellant's decision, on the basis that the charter fees paid by the respondent were "business income" of non-resident companies. Without a permanent establishment having been set up by the non-resident companies, the appellant could not tax such income hence relieving the respondent of the duty of withholding the tax on their behalf.

A. The appellant's position at all levels

The appellant held the simplistic view that the payments for the charter fees were *a special class of income* under section 4A (iii) of the Act and thus subject to withholding tax under section 109B (1) of the Act. It further canvassed that the generic tax relief provided for in Article IV of the DTA as relied upon by the respondent was not to be read in isolation but read together with, and in the context of Article VI, VII, VIII and XV of the DTA. Admittedly, Article IV does provide that in each of the countries in which these non-resident companies carry on business, tax may only be imposed on such income in the respective countries where

they actually reside, so long as they do not have a permanent establishment in Malaysia. On the other hand Article VI of the DTA stipulates that *"notwithstanding the provisions of Article IV … the income or profits of an enterprise of one of the contracting states from* ***the operation of ships*** *… in international traffic may be taxed in the other contracting state only if such income or profits are derived from that other state…"* In short Article VI expresses that income from the operation of ships could be the subject of tax if derived from Malaysia. Regardless of the instruction under the latter Article, under Article XVIII of the DTA the Act still governs the taxation of income derived from Malaysia. It reads as follows:

Article XVIII

"**The laws of Malaysia shall continue to govern the taxation of income derived from Malaysia except where express provision to the contrary is made in this Agreement**. The laws of Singapore shall continue to govern the taxation of income arising in Singapore except where express provision

to the contrary is made in this Agreement. Where income is subject to tax in both Contracting States, relief from double taxation shall be given in accordance with the following paragraphs of this Article. (emphasis ours)..."

The appellant ventilated that section 4A (iii) of the Act, which took effect from 30.12.1983, was amended specifically to cover situations such as the instant case, where it provides that *"rents or other payments made under any agreement or arrangement for the use of any moveable property is deemed to be derived from Malaysia under section 15B of the Act and therefore subject to withholding tax [of the non-resident companies] under section 109B of the Act"*. Further, the appellant averred that such rental income was not business income pursuant to section 24(8) of the Act. For completeness we reproduce the latter sub-section which reads as follows:

"24. Basic period to which gross income from a business is related

(1) …

(2) …

(3) …

(4) …

(5) …

(6) …

(7) …

(8) This section shall not apply to income under section 4A."

B. <u>The respondent's position at all levels</u>

The respondent's stand was as follows. Resident companies which engaged non-resident companies on a time-charter basis were not obliged to withhold any taxes from payments of the charter fees. The basis of this position was that the non-resident companies received payment from the respondent as 'business income' through 'cross-border activities'. The respondent ventilated that under Article IV of the DTA, in each of the countries in which these non-resident companies carried on business, tax may only be

imposed on such income in the respective countries where these non-resident companies actually reside, so long as these non-resident companies do not have any permanent establishment in Malaysia. The rationale was that by not having a permanent establishment in Malaysia, these non-resident companies were not regarded as participating in the economic life of Malaysia, thus falling outside the Malaysian taxing jurisdiction.

The High Court's decision

The High Court quashed the appellant's decision and in doing so, inter alia adjudged that the maintenance of a permanent establishment in Malaysia was a key factor in deciding whether the income or profits of the Singapore enterprise was to be taxable or not in Malaysia. It said:

> *"…following the case of Hock Heng Company Sdn Bhd v DGIR, the test to be applied is whether or not the Singapore non-resident enterprise maintains a permanent establishment in Malaysia.*

> *Once it is established that the Singapore enterprise does not maintain a permanent establishment in Malaysia, which the [LHDN] concedes, then the income or profits of the Singapore enterprise shall not be taxable in Malaysia...if (the non-resident companies) do not carry on business through a permanent establishment in Malaysia, then by virtue of s.132 of the Act, such (companies) are afforded protection from taxation under Article IV and its income or profits "shall not be taxable in Malaysia"... the [LHDN] concedes that the non-resident companies do not have a permanent establishment in Malaysia...hence Article IV of the DTA afforded relief from taxation to these companies...I am of the view that the [LHDN] has misconstrued Article IV and had thereby committed error of law."*

As said above, being dissatisfied with the High Court's decision, the appellant filled an appeal at the Court Of Appeal.

The Court of Appeal's decision

The Court of Appeal affirmed the High Court's decision and in the course of doing so also opined that the Privy Council's case of *Hock Heng Company Sdn Berhad* v *Director-General of Inland Revenue [1979] 2 MLJ 51* supported the respondent's position. The Court of Appeal stated that as the non-resident companies did not have any permanent establishment 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 anything. It also opined that the provisions of these treaties took precedence over the Act.

Our analysis

The matter before us depends very much on the interpretation of the Act and the international treaties that Malaysia has entered into with other countries. With the onus being on the appellant to prove that the non-resident companies are subject to tax, this hurdle must be

overcomed first. The first step to be undertaken is the scrutiny of the Act. The scrutiny must be carried out fairly and when convinced of the clarity of the provision (read together with the facts before us), a decision then follows. In short, effect is given to the clear terms; if he falls under the Act then he must be taxed. Otherwise he is freed of any tax (*Exxon Chemical (Malaysia) Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri [2005] 4 CLJ 810*). To quote the historical and oft-quoted Rowlatt J in *Cape Brandy Syndicate v Inland Revenue Commissioner (12 TC 358)*:

> "There is no room for any intendment, there is no equity about a tax; there is no presumption as to a tax; you read nothing in; you imply nothing; but you look fairly at what is said and what is said clearly that is the tax."

In gist, when interpreting provisions in a taxing Act the intention of Parliament must be construed from the language used and for the Court to interpret it accordingly

(*Cheatley v. The Queen [1972] 127 CLR 291; Attorney-General (Canada) v. Hallet & Carey Ltd. [1952] AC 427; Glaisdale in Farrell v. Alexander [1978] AC 59; Hatton v. Beanmont [1977] 2 NSWLR 211).* The matter may be summarily dealt with if the language is plain and unambiguous and admits of only one meaning. In *Kamla Devi v Takhatmal [1964] AIR SC 859* the court remarked**:**

> "If the language is clear and unambiguous and applies accurately to existing facts, it shall accept the ordinary meaning, for the duty of the Court is not to delve deep into the intricacies of the human mind to ascertain one's undisclosed intention, but only to take the meaning of the words used by him, that is to say his expressed intentions"**.**

On the other hand if the words are not so explicit, then it is incumbent upon the court to undertake an exercise to seek out the purpose of Parliament, but without sacrificing

justice or importing the absurd. The purposive approach is not a new concept as way back in *AG v Carlton Bank [1899] 2 QB 158* Lord Russel of Killowen CJ shot a salvo when he stated that all Acts ought to be construed no differently, "*whether the Act to be construed relates to taxation or any other subject, viz. to give effect to the intention of the legislature."*

Then came the Ramsey principle. Without the need to delve deeply into the history of changes in the attitude of courts (in the like of *Luke v IRC [1963] AC 557*) in the interpretation of taxing Acts, Lord Wilberforce in *WT Ramsay Ltd v Inland Revenue Commission [1982] AC 300*, had occasion to enunciate:

> "A subject is only to be taxed on clear words, not on 'intendment' or on the 'equity' of an Act…What are 'clear words' is to be ascertained on normal principles; these do not confine the courts to literal interpretation. They may, indeed should be considered in the context and

> scheme of the relevant Act as a whole, and its purpose may, indeed should, be regarded..."

The above approach was again tested in *Pepper (Inspector of Taxes) v Hart [1993] AC 59*. The above shift in approach by British Courts i.e. to take into consideration the purpose of an Act, is in consonant with our section 17A of the Interpretation Acts 1948/ 1967, effective on 25.7.1997, which reads:

> "In the interpretation of a provision of an Act, a construction that would promote the purpose or object underlying the Act (whether that purpose or object is expressly stated in the Act or not) shall be preferred to a construction that would not promote that purpose or object".

In *Palm Oil Research and Development Board Malaysia & Anor v. Premium Vegetable Oils Sdn Bhd [2004] 2 CLJ 265* Gopal Sri Ram JCA (as he then was) had occasion to state:

> "When construing a **taxing** or other statute, the sole function of the court is to discover the true intention of Parliament. In that process the court is under a duty to adopt **an approach that produces neither injustice nor absurdity**, i.e., an approach that promotes the purpose or object underlying the particular statute albeit that such purpose or object is not expressly set out therein (emphasis supplied)."

In *Palm Oil Research and Development Board Malaysia & Anor v Premium Vegetable Oils Sdn Bhd & Another Appeal [2005] 3 MLJ 97*, Steve Shim CJSS when discussing section 17A of the Interpretation Acts 1948 and 1967, enjoined the purposive approach to statutory interpretation, in that it equally applied to taxing statutes. His Lordship in no uncertain terms said:

> "The duty of a court is, in my opinion, in all cases the same; whether the Act to be construed relates to taxation or any other subject, viz. to give effect to the intention of Legislature."

After tracing the history of how courts treat the interpretation of taxing Acts, culminating with the promulgation of section 17A of the 1948/1967 Interpretation Acts and subsequent cases, the purposive approach is here to stay. The intention of Parliament therefore cannot be discounted even if the matter in the Act pertained to taxing issues.

Nature of Income

So, are the non-resident companies subject to Malaysian tax in the circumstances of the case? In order to decide whether they are subject to tax in Malaysia, which inevitably depends on whether they fall within the letter of the Act as discussed above, a need arises to consider

whether their income falls under the heading of *business income* or *as special classes of income* under the Act.

Under section 3 of the Act a person is charged for each year of assessment upon income accrued in or derived from Malaysia or received in Malaysia from outside Malaysia. The classes of income on which tax is chargeable is laid out under section 4 of the Act. This provision reads as follows:

> "**4. Classes of income on which tax is chargeable**.
>
> Subject to this Act, the income upon which tax is chargeable under this Act is income in respect of-
>
> *(a)* gains or profits from a business, for whatever period of time carried on;
>
> *(b)* gains or profits from an employment;
>
> *(c)* dividends, interest or discounts;
>
> *(d)* rents, royalties or premium;

> *(e)* pensions, annuities or other periodical payments not falling under any of the foregoing paragraphs;
>
> *(f)* gains or profits not falling under any of the foregoing paragraphs."

The above section, which ropes in taxable income from any business, employment and the like, therefore imposes tax even on any non-resident company unless relief is granted by a DTA. Regardless of the prominence of the DTA, we must also not lose sight of the fact that the charging law is the Act, and not the DTA. The DTA is merely the mechanism to eliminate double taxation or to grant relief, and has no jurisdiction as regards the imposition or creation of tax. L.C Vohrah J in *Walter Wright (Singapore) Pte Ltd v Director General of Inland Revenue [1990] 2 MTC 115* (a case decided prior to the introduction of section 4A of the Act) in crystal clear terms said:

> *"I agree with counsel for the appellant that the nature of the income has to be determined by*

the ITA (Income Tax Act) and the law which charges it to tax also has to be the ITA and that only once these factors are established according to the Malaysian domestic law, can the DTA be resorted to in order to determine whether relief is available."

As this appeal relates to cross-border business, a need arises for us to understand the already mentioned DTA i.e. the 'Malaysian–Singapore Double Taxation Avoidance Agreement' (the DTA) and the Double Taxation Relief (Singapore) Order 1968, P.U.518/1968 (the Order). Prior to the DTA and the Order, the incidence of double taxation would befall a taxpayer for the same transaction or income source. With mitigation of grievances and avoidance of double taxation in mind, DTAs and Orders were entered into between the Government of Malaysia and other sovereign countries; not only was the incidence of disgruntlement reduced with those countries but the rightful country to impose the tax was determined.

With the signing of DTAs and Orders, section 132 of the Act is activated. This section, which inter alia deals with matters of double taxation arrangement, reads as follows:

"**Double taxation arrangements**

132. (1) If the Minister by statutory order declares that –

(a) arrangements specified in the order have been made by the Government with the government of any territory outside Malaysia with a view of affording relief from double taxation in relation to tax under this Act any foreign tax of the territory; and

(b) it is expedient that those arrangements should have effect, then, so long as the order remains in force, those arrangements shall have effect in relation to tax under this Act **notwithstanding anything in any written law**.

(2) …

(3) …

(4) Any arrangements to which effect is given under this section may include –

(a) provision for relief from tax with respect to any person of any particular class;

(b) provision as to income which is not itself subject to double taxation;

(c) provision for exempting from tax any person or any person of any particular class or for exempting from tax (wholly or in part) the income of any person or any person of any particular class; and

(d) in addition to provisions for relief from double taxation, other provisions relating to tax under this Act or to foreign tax of the territory to which the arrangement relate,

and any such arrangements containing any such provision may with respect to that provision be made to have effect for periods before the passing of this Act or before the making of the arrangements,

and the foregoing subsections shall be construed accordingly.

(5) …

(6) … (*emphasis ours*)"

Without the need to restate the positive effect of any DTA, the above provision has prioritized any DTA, and by the Order of the relevant Minister, this bilateral treaty takes a pre-eminent position vis-à-vis domestic tax laws (*Director-General of Inland Revenue v Euromedical Industries Ltd [1983] CLJ (Rep) 128, FC*). The legislated words in section 132 (1) (b) which read, "…notwithstanding anything in any written law" clearly gives the effect of giving precedence over domestic law (*In Re Geoffrey Robertson [2001] 4 CLJ 317*).

In order to grant conditional relief to the income falling under section 4 of the Act, Article IV as agreed upon in the DTA with Singapore, takes centre stage. It reads as follows:

ARTICLE IV

> 1. (a) the income or profits of a Singapore enterprise shall not be taxable unless the enterprise carries on a business in Malaysia through a permanent establishment situated in Malaysia. If the enterprise carries on business as aforesaid, tax may be imposed in Malaysia on the income or profits of the enterprise but only on so much thereof as is derived by that permanent establishment."

It is obvious that non-resident companies would be granted relief but conditional on the said income falling under s.4 (a) of the ITA and subject to the non-resident companies establishing the absence of permanent establishment in Malaysia. Effective on 30.12.1983, with the promulgation of s.4A of the Act, the tax landscape changed. This provision, which was legislated by Parliament following the decision in *Director-General of Inland Revenue v Euromedical Industries Ltd [1983] CLJ (Rep) 128*, reads:

"4A. **Special classes of income on which tax is chargeable**

Notwithstanding the provisions of section 4 and subject to this Act, the income of a person not resident in Malaysia for the basis year for a year of assessment in respect of -

(i) …;

(ii) …;

(iii) rent or other payments made under any agreement or arrangement for the use of any moveable property,

which is derived from Malaysia is chargeable to tax under this Act (emphasis ours)."

The above provision has created a *special class of income* 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. To put into effect the taxability of rentals from moveable

property (though a commonsense reading would suffice to include rentals of vessels under the terminology of 'any moveable property'), in relation to Singapore, Article II (*l*) in the DTA has cleared any lingering doubt. Under Article II, (*l*) the terms "income or profits" be it for Malaysian or Singapore enterprise' do not include, amongst others, income derived from the operation of ships or aircraft, thus neatly sidestepping section 4 of the ITA.

For easy reference we reproduce herewith the relevant portion of Article II, which reads:

Article II

1. In this Agreement, unless the context otherwise requires-

   (*a*)…;

   (*l*) **The terms "income or profits of a Malaysian enterprise" and "income or profits of a Singapore enterprise"** ***do not include*** rents or royalties in respect of literacy or artistic copyrights, motions picture films or of tapes for television or broadcasting

> or of mines, oil wells, quarries or other places of extraction of natural resources or of timber or forest produce, or income in the form of dividend, interest, rents, royalties or fees or other remuneration derived from the management , control or supervision of the trade, business or other activity of another enterprise or concern or remuneration for labour or personal services or **income derived from the operation of ships or aircraft** (emphasis ours).

Nothing is mentioned in Article II (*l*) of any relief being granted were there to be any permanent establishment set up in Malaysia by the non-residents for the *special class of income.* This silence is also seen in Article VI of the DTA Malaysia/Singapore and in fact silenced by the phrase, '*Notwithstanding the provisions…*' The above view regarding phrases of this nature equally applies here; Article VI therefore takes prominence over Article IV, thus entitling the Malaysian government to tax non-resident companies, subject to the given conditions. This Article provides as follows:

> "1. **Notwithstanding the provisions** of Article IV of this Agreement the income or profits of an enterprise of one of the Contracting States from the operation of ships or aircraft in international traffic may be taxed in the other Contracting State only if such income or profits are derived from that other Contracting State…(emphasis ours)"

With the income of the non-residents in the circumstances of the case falling under section 4A (iii) and dealt with differently by the Act and the DTA, Article IV is thus inapplicable to the instant facts.

Finding

With the introduction of section 4A (iii) of the Act, read together with Articles II and VI of the DTA, the Government of Malaysia may tax a non-resident company's income, categorized as *special classes of income*, without the

previous fear of the specter of a permanent establishment having been established in Malaysia. In the course of construing the relevant provisions of the Act and DTA neither did we find anything unjust or absurd in the purpose of Parliament.

We find that the respondent in this appeal had made payments to non-resident companies in respect of vessels and crews hired under "Uniform Time Charter Party for Offshore Service Vessels" contracts, with the income received by the non-resident companies as *special classes of income*. As it was the intention of Parliament to tax non-resident companies from Singapore in the circumstances of the case, and with Article IV being inapplicable to income received under section 4A (iii), the payments received by the non-residents were therefore taxable. It was thus incorrect on the part of the High Court and the 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 permanent establishment as demanded by *Hock Heng Company Sdn. Berhad v Director General Of*

Inland Revenue [1979] 2 MLJ 51, and giving no weight to section 4A (iii) of the Act.

Needless to say, the intention of Parliament to collect tax from non-residents who have received payments from Malaysians, would be rendered ineffective unless associated provisions are also promulgated to allow the collection of tax at source. That tax collected at source may be referred to as withholding tax, with the associated provision in the Act for collection being section 109B. This section reads as follows:

> "109B. Deductions of tax from special classes of income in certain cases derived from Malaysia.
>
> (1) where any person (in this section referred to as "the payer") is liable to make payments to a non-resident-
>
> (a) …
>
> (b) …
>
> (c) for rent or other payments made under any agreement or arrangement

> for the use of any moveable property, which is deemed to be derived from Malaysia, he shall, upon paying or crediting the payments, deduct therefrom tax at the rate applicable to such payments……"

In the circumstances of the case as the non-resident companies in this appeal are taxable, section 109B of the Act is triggered, and the respondent is forthwith statutorily bound to withhold a portion of the payments as tax. To reiterate, this provision is a tax collection mechanism primarily to ensure collection of the tax due *from any person liable to make payments* to *a non-resident person* (or non-resident companies in the circumstances of the case) (*The Law and Practice of Singapore Income Tax by Pok Soy Yoong page 405*). In this appeal the two preconditions do exist viz. the respondent is liable to make payments, and the payment is to a non-resident(s) for the use of moveable property.

Decision

As the income paid to the non-resident companies is subject to tax the answer to the question for our determination is in the positive.

The appeal is allowed with costs. The orders of the High Court and Court of Appeal are set aside. The deposit is refunded.

Dated this 17th day of October 2013

t.t

SURIYADI HALIM OMAR
Judge
Federal Court, Malaysia

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