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July 2018

Greetings from
Deloitte Malaysia Tax Services

Quick links: *Deloitte Malaysia*
Inland Revenue Board of Malaysia

Takeaways:

1. Practice Note No. 2/2018
2. IBM Malaysia Sdn Bhd v KPHDN (High Court)

Upcoming events:

1. *(Penang) Deloitte International Tax Symposium 2018*
2. *(Ipoh) Tax Audit and Investigation Seminar*

Important deadlines:

Task	2018 Due Date	
	31 July	**1 August**
1. 2019 tax estimates for companies with August year-end		√
2. 6th month revision of tax estimates for companies with January year-end	√	
3. 9th month revision of tax estimates for companies with October year-end	√	
4. Statutory filing of 2017 tax returns for companies with December year-end	√	
5. Due date for 2018 CbCR notification for companies with July year-end	√	

Practice Note No. 2/2018

The Inland Revenue Board of Malaysia ("IRBM") has on 1 June 2018 issued Practice Note No. 2/2018 (currently in Bahasa Malaysia version only) to explain the non-application provision set out in the Income Tax Orders ("ITO") and Income Tax Rules ("ITR") issued under the Income Tax Act 1967 ("the ITA").

The Practice Note No. 2/2018 clarifies that the non-application rule contained in the ITO and ITR which concerns Section 127 of the ITA is confined to exemptions made under Section 127(3)(b) and Section 127(3A), and not Section 127(1) of the ITA (i.e., not meant to include exemption specified in Part I of Schedule 6 of the ITA made under Section 127(1) of the ITA). The IRBM has also given two illustrations (i.e., Example 1 and Example 2) in the Practice Note No. 2/2018.

Essentially, the non-application provision in the ITO and ITR means a taxpayer can claim only one incentive in a year of assessment ("YA").

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IBM Malaysia Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri (KPHDN) (High Court)

Issues:

1. Whether the taxpayer's application for judicial review was filed prematurely;
2. Whether the advance ruling affected the taxpayer when the taxpayer could opt not be bound by the advance ruling.
3. Whether the advance ruling was a 'decision' which was amenable to judicial review;
4. Whether the alternative or domestic remedy was available under the ITA for advance ruling; and
5. Whether the distribution fee payable by the Malaysian resident taxpayer to a Netherland resident company, i.e., IBM Ireland Product Distribution Limited ("PDL") under the draft software distribution agreement ("Agreement") was royalty.

Decision:

The High Court allowed the application for judicial review by the taxpayer with the following grounds of judgement:

Issue 1

1. The advance ruling issued by the IRBM was in regard to the YAs 2016 to 2030. In coming to the decision, the IRBM knew that the then proposed arrangement was seriously contemplated by the taxpayer that a concerted effort and a definite course of action had been made to undertake the arrangement in the near future [Paragraphs 5.1 and 5.2 of the Guidelines on Advance Ruling ("the Guidelines")].

The taxpayer was taking steps to get the court intervention to quash the IRBM's advance ruling before submitting the return. There was no qualification stated in the advance ruling for the IRBM to change its decision. Therefore, as far as the advance ruling was concerned in relation to the arrangement for the period or YA specified in the advance ruling, the taxpayer had no choice but to accept that the payment to PDL was royalty and subject to withholding tax under the ITA. This was because the advance ruling was final as stated in Paragraph 16 of the Income Tax (Advance Ruling) Rules 2008 ["the Rules"].

2. By subjecting the distribution fee to withholding tax, the IRBM had altered and deprived the taxpayer of its rights, as the taxpayer would suffer financial detriment and would have to pay a tax. The advance ruling was final and binding. There was an issue of law whether such payment of tax was authorised by any legislation or authority.

3. The taxpayer's application for judicial review was not premature.

Issue 2

Based on the explanation in the above paragraphs and in the circumstances of this case, it was the High Court's view that the issue of whether the taxpayer could opt not be bound by the advance ruling did not arise. It was for the taxpayer to take the necessary steps to challenge the IRBM's advance ruling.

Issue 3

The Explanatory Note to Clause 26 of the Finance Bill 2006 and the Rules had explicitly stated that the Advance Ruling was final and binding on both parties. In this regard, it would be quite unreal to suppose that the advance ruling was a mere opinion and that was not decisive. Section 138B of the ITA was binding on the taxpayer and the IRBM. In this regard, the IRBM had no basis to aver that the advance ruling did not amount to a 'decision'.

Issue 4

1. There had not been any notice of assessment or assessment issued by the IRBM to the taxpayer. As a result of that, the taxpayer did not have a right to appeal under Section 99 of ITA. In *Malayan United Industries Bhd v Ketua Pengarah Hasil Dalam Negeri & Anor (2005) MSTC 4,192;[2006] 5 CLJ 240*, the High Court held that in cases where no assessment had been made, judicial review was the most appropriate, convenient and suitable procedure for the taxpayer to challenge the IRBM's decision.

2. Furthermore, the remedy to appeal to the SCIT under Section 109H of the ITA was not available to the taxpayer as at the time when the IRBM's decision via the advance ruling and the taxpayer's application for judicial review were made, no amount was due from the taxpayer to the IRBM under Section 109, 109B or 109F of ITA.

Issue 5

1. Clearly, the Agreement only granted the taxpayer the right to distribute software programs in Malaysia and there was no element of proprietary rights or know-how being granted or transferred to the taxpayer.

2. In a transaction where a distributor made payments to acquire and distribute software copies (without the right to reproduce the software), the rights in relation to these acts of distribution should be disregarded in analysing the character of the transaction for tax purposes. Payments in these types of transactions would be dealt with as Business Profits under Article 8 of the Malaysia-Netherlands Double Taxation Agreement (P.U.(A) 214/1988) ("the DTA").

3. One had to take cognisance of Article 8 of the DTA and apply the definition of 'royalty' as provided under Article 13(6) of the DTA and supplemented by the Organisation for Economic Cooperation and Development ("OECD") Commentary on Article 12. By applying the definition of 'royalty' under the DTA, the 'distribution fee' did not fall under the definition of 'royalty' under Article 13(6) of the DTA.

In its conclusion, the High Court held that the decision of the IRBM in its advance ruling dated 7 June 2016 was *ultra vires,* illegal, void, unlawful and/or in excess of authority as "distribution fee" payable to PDL under the Agreement for the purchase, distribution and sale of PDL's products (i.e. software programs) was not royalty.

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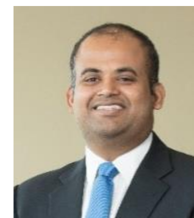

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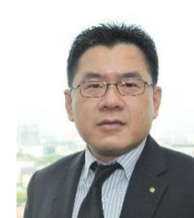

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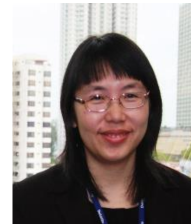

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