MyRinggit

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# Boosting Tax Collection

Tax avoidance and the rule to void your transaction.

'The avoidance of taxes is the only intellectual pursuit that carries any reward.' – John Maynard Keynes. Anyone inclined to be inspired by this statement of this great man should think again. Tax officials everywhere, including Malaysia, are targeting tax avoidance activities to enhance tax collections.

Whilst tax avoidance is not illegal, unlike evasion, many tax-avoidance activities are considered unacceptable by many countries. Unacceptable tax avoidance comes up against the ubiquitous rule, the GAAR or General Anti-Avoidance Rule.

The GAAR has a long history in Malaysian tax law. The first GAAR provision was contained in the Income Tax Ordinance (1947) (the Ordinance) when the country had yet to attain independence from Britain. The provision had similarities with those of its former colonies such as Hong Kong and Singapore since their tax systems were derived from an 'Empire' model.

The GAAR under the Ordinance adopted the sham principle. The provision under its Section 29 read as follows:

'(1) Where the Comptroller is of the opinion that any transaction which reduces or would reduce the amount of tax payable by any person is artificial or fictitious or that any disposition is not in fact given effect to, he may disregard any such transaction or disposition and the person concerned shall be assessed accordingly.'

The intent is not to apply the sham doctrine in the wider sense, but to a situation where a sham transaction has the effect of reducing the tax liability of the person or to a transaction where the document is not the actual agreement, which binds them.

**THUS, THE VIEW THAT TAX MITIGATION CAN BE DISTINGUISHED FROM TAX AVOIDANCE CAN HAVE NO STRONGER LEGAL SUPPORT. THIS MARKS THE CORNERSTONE UPON WHICH TAX PLANNING IN MALAYSIA CAN BE SAID TO RELY.**

The Federal Court in the case of CIT v AB Estates Ltd (1985) MSTC 95 held that 'a sham transaction is one which is mainly designed to pass off an existing state of things as other than what it really is'.

The sham doctrine was abandoned in favour of a broader approach towards anti-avoidance when the Income Tax Act, 1967 (the Act) was enacted to replace the 1947 Ordinance. Here the GAAR is Section 140, which mirrors the-then Section 260 of the Australian legislation before its repeal. The rule essentially empowers the Director-General of the Inland Revenue to ignore a transaction considered to have the direct or indirect effect of:

- altering the incidence of tax;
- relieving any person from liability to pay any income tax or make any return;
- evading or avoiding any duty or liability imposed on any person by this Act; or
- hindering or preventing the operation of this Act in any respect.

Section 140 considers whether a transaction has the 'direct or indirect effect' of 'altering the incidence of tax etc...' whereas the Australian rule questions whether the transaction has the 'purpose' of altering the incidence of tax. The absence of the word 'purpose' does seem to give it a wider scope than Australia's Section 260. Fullagar J in the Australian case of Commissioner of Taxation v Newton [1958] 98 CLR 1] decried the unusually wide nature of the rule. He said, 'If the word "purpose" was to be given its literal meaning, it would seem to apply to cases which it is hardly conceivable that the legislature should have had in mind.'

The wide meaning of our section 140 meant that over the years, the revenue authorities in Malaysia tended to 'read down' this provision. This, in part, explains why the section has rarely been invoked for much of the 40-odd years the measure was in force with the legal language unchanged.

There has, therefore, been less than a handful of cases on tax avoidance that have found their way to the appeals tribunal, ie, the Special Commissioners of Income Tax or the Courts. Thus, interpreting the difficult provision of Section 140 remains problematic.

The case of SBP Sdn Bhd v DG IR [(1988) 1 MSTC 2053] provided some help. It gave prominence to the 'commercial purpose' test. The case involved a company, which had ceased tin-mining operations with unabsorbed losses. An operating tin mine was acquired by the company and the future profits from this mine was to be set-off against the losses available in the company. The Revenue invoked Section 140 to disallow the losses for set-off.

Not surprisingly, the Special Commissioners made comparison with Section 260 of the Australian legislation. They noted that the word 'purpose' was present in Section 260 but absent in Section 140. They cited the case of Laurie Joseph Newton v The Commissioner of Taxation of the Commonwealth of Australia (1958) 2 All ER 759 (PC) where the Privy Council had this to say:

'The word "purpose" means not motive but the effect which it is sought to achieve-the end in view. The word "effect" means the end accomplished or achieved. The whole set of words denote concerted action to an end-the end of avoiding tax.'

Despite the absence of the word 'purpose', the Special Commissioners felt entitled to ask as a matter of fact what the purpose of the taxpayer was in taking the steps that he took. They rejected the taxpayer's claim that the transaction was commercially motivated but said that the transaction was 'single-mindedly' driven by tax avoidance.

The need to consider the relevance of commerciality was again brought up in the case of LD Timber v DG of IR (1978) 1ML J 203 where at the High Court, Justice Yusoff said:

' ...... in order to see that the transaction in this case had the effect of altering the incidence of tax, it must be shown that the transaction is not capable of explanation by reference to ordinary business dealing without necessarily being labelled as a means to avoid tax.'

Both these cases tend to provide some guidance as to the importance of the 'business purpose' test in the context of GAAR. It is another way of saying that any transaction entered into without a business purpose but with the intent of achieving a tax benefit is tax avoidance. It fits in with the meaning that the UK House of Lords in the case of Willoughby has given to it 'a course of action designed to conflict with or the defeat of the evident intention of Parliament'.

This is also in sync with how the OECD (Organisation of Economic Cooperation & Development) explains it: 'The arrangement of a taxpayer's affairs that is intended to reduce his tax liability and although the arrangement could be strictly legal, it is usually in contradiction with the intent of the law it purports to follow'.

The question then is whether a transaction, which is deemed to have avoided tax, will carry with it a penalty. Here, the UK Tax Law Review Committee in considering the question had this to say in its report published in February 2009: '...the question as to whether some form of penalty should be imposed to deter tax avoidance. If yes, this should be by way of an explicit penalty and not at the expense of the coherence of the tax system ...'

This same sentiment can be said of Section 140 in relation to the overall provisions of the Income Tax Act 1967. There is no explicit penalty provision when a taxpayer is deemed to have avoided tax under Section 140. Any penalty imposed under such circumstances would seem 'incoherent' as a return has to be de facto incorrect and not deemed incorrect. Put simply, if it is not illegal to enter into a transaction deemed to avoid tax, then to subject it to a penalty does not make sense in the absence of an explicit penalty provision deeming it to be incorrect.

Tax avoidance has been considered by commentators to be either acceptable or unacceptable. This dichotomy has been made somewhat redundant by judicial pronouncements. In the case of Sabah Berjaya Sdn Bhd v KPHDN (1993) 3 MLJ 145, the Court of Appeal dealt with the difference between tax avoidance and tax mitigation. The case involved a company making donations to its shareholder rather than paying dividends. The revenue disregarded the donations by invoking Section 140. Gopal Sri Ram JCA in deciding for the taxpayer said:

'The appellant was not engaging in tax avoidance. For it did not do anything which did not reduce its income or suffer a loss, nevertheless resulting in it obtaining a reduction in its liability to tax as if it had. Accordingly in my judgment this is not a case to which s.140 of the Act applies.'

Thus, the view that tax mitigation can be distinguished from tax avoidance can have no stronger legal support. This marks the cornerstone upon which tax planning in Malaysia can be said to rely. mb

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