Tax Appeals In Malaysia And Indonesia

Regional Tax Appeals And Landmark Cases

25 September 2024, Wednesday

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KEY TAKEAWAYS

- Understanding the nuanced complexities of various tax systems and appeal processes across the region will help Singapore tax professionals better manage their organisation's tax strategies, ensure compliance, and mitigate tax risks.
- Unlike the common law systems in Singapore and Malaysia, Indonesia has a civil law system which does not follow the strict doctrines of precedent.
- Malaysia's Court of Appeal held that the valuation method was irrelevant in determining whether the gain received was capital or revenue in nature.

As Singapore is a popular head office location, Singapore tax professionals have a pivotal role to play in helping multinational enterprise (MNE) groups navigate the intricate regional tax landscape.

To keep tax professionals up-to-date on the regional tax landscape, the Singapore Chartered Tax Professionals organised a seminar where three regional tax experts came together to share valuable insights into the tax systems and appeal processes in Indonesia and Malaysia, illustrating the nuances in each country through landmark tax cases.

"By having a good grasp of the nuanced complexities of various tax systems and appeal processes across the region, Singapore tax professionals would be better prepared to manage their organisation's tax strategies, ensure compliance, and mitigate tax risks in the jurisdictions their respective organisation operates in," shared Ponti Partogi, Senior Partner and Head of Tax & Customs Group at HHP Law Firm, along with Jason Liang, Partner, and Jeff Sum, Senior Associate, Wong & Partners.

Tax Systems and Appeal Processes

MALAYSIA

Tax System

The Income Tax Act 1967 sets out the powers of the Inland Revenue Board of Malaysia (IRBM) to conduct audits and investigations, as well as the procedures applicable in disputing an assessment for income tax.

Malaysia adopts a self-assessment system, where the taxpayers are responsible for computing their own tax payable and submitting their tax returns. IRBM has the power to conduct tax audits on taxpayers to verify their compliance with tax laws.

The time-bar period for IRBM to conduct an audit and raise an assessment or additional assessment is five years from the expiration of the relevant year of assessment (YA) (save for transfer pricing matters, where the time-bar period is seven years). Under the Income Tax Act 1967, the time-bar period does not apply where there is fraud, wilful default, or negligence.

Appeal Process

Under the Income Tax Act 1967, the assessed taxes and penalties are due upon issuance of the notice assessment and must be paid by the taxpayer notwithstanding any appeals.

A taxpayer may initiate an appeal by filing a notice of appeal (Form Q) with the DGIR within 30 days after the service of the notice of assessment.

Upon the filing of Form Q, DGIR has 12 months to consider the appeal internally. During this period, IRBM may reach out to the taxpayer for further discussion or settlement. If settlement is unlikely, IRBM will forward the case to the Special Commissioners of Income Tax (SCIT).

Once SCIT receives Form Q, it will fix the matter for mention, case management, trial and decision. If either IRBM or the taxpayer is not satisfied with SCIT's decision, the party may further appeal to the High Court, based on the facts found by SCIT. The final appeal of the matter will be before the Court of Appeal.

INDONESIA

Tax System

Indonesia has a civil law system. Unlike the common law systems in Singapore and Malaysia, it does not follow the strict doctrines of precedent, and each case must be determined on its own facts and merits.

Due to this fundamental difference, foreign taxpayers from common law jurisdictions may find judgements in Indonesia to be more unpredictable than they are used to.

The country applies a self-assessment system for income tax. The Directorate General of Taxation (DGT) ensures compliance through tax audits, which will be followed by the issuance of tax assessment letters.

Appeal Process

A taxpayer may appeal against an assessment made by the local tax office by submitting an objection petition to DGT (addressed to the head of the regional head office). The objection petition has to be filed within three months after the date of the tax assessment letter.

Once the objection petition has been filed, DGT must issue a decision within 12 months. If it fails to do so, the objection petition is deemed granted.

If DGT rejects the objection petition, the taxpayer may submit an appeal petition in writing to the tax court within three months after receiving the decision.

The tax court's decisions are final and binding, although the taxpayer may pursue an extraordinary legal proceeding and challenge the tax court's decision under certain specific circumstances. To do this, the taxpayer has to submit a request for a reconsideration petition (or a civil review petition) in writing to the Supreme Court, Indonesia's highest court.

Recent Landmark Tax Case in the Region

MALAYSIA: *KEYSIGHT TECHNOLOGIES MALAYSIA SDN BHD V KPHDN* [2024]

The taxpayer, Keysight Technologies Malaysia Sdn Bhd, was a full-fledged manufacturer of various microwave devices, test accessories, amplifiers and transceivers. In the course of its operations as a full-fledged manufacturer, the taxpayer developed technical knowhow in manufacturing and marketing activities (IP rights).

As part of a global restructuring exercise, the taxpayer sold its IP rights to a foreign-related company. The taxpayer was then granted a licence to continue using the IP rights and converted from a full-fledged manufacturer to a contract manufacturer. The receipt from the sale of IP rights was reported in the tax returns for YA 2008 as a capital gain and therefore, not taxable.

A few years later, IRBM initiated an audit on the transaction and assessed the proceeds from the sale of IP rights as income, on the basis that the proceeds represented compensation for the loss of the taxpayer's income. Consequently, IRBM issued a Notice of Additional Assessment to impose additional tax and 45% penalty amounting to RM311 million, some nine years after the relevant YA and after the expiry of the five-year time-bar period.

Court of Appeal's Decision

The Court of Appeal agreed with the taxpayer that the "badges of trade" test was the correct legal standard for distinguishing capital and income receipts in Malaysia, and not merely confined to the receipt or disposal of land or property, as submitted by IRBM.

It added that the "outright sale" test (which IRBM had relied on) lacks credible legal authority and is not the proper test to be used in distinguishing between the capital or income nature of a receipt.

Applying the "badges of trade" test, the undisputed facts indicated that the receipt is capital in nature. For example, the taxpayer is not and has never been in the business of buying and selling of IP rights; the IP rights are capital assets used by the taxpayer in the production of products when it was previously a full-fledged manufacturer; and the sale was a one-off transaction and there were no other sales of knowhow. Under the circumstances, the Court of Appeal held that the sale of the IP rights was a disposal of capital assets and thus not taxable as income under the Income Tax Act 1967.

On IRBM's argument that the proceeds were a compensation for loss of income based on the valuation methodology (that is, the discounted cash flow method), the Court of Appeal held that the valuation method was irrelevant in determining whether the gain received was capital or revenue in nature.

The Court of Appeal allowed the taxpayer's appeal and ordered that the assessed taxes and penalties paid be refunded in full to the taxpayer.

Conclusion

A good understanding of the intricacies and nuanced complexities of the tax systems and appeal processes across the region will help organisations mitigate the tax risks in each jurisdiction. Here are a few key takeaways to help you navigate the region:

PROFESSIONAL ADVICE

Seeking professional advice early is crucial to ensure that transactions are correctly treated and defensible against future tax audits and disputes, in accordance with prevailing legislation and legal precedents.

This is especially important if the transaction is significant or if you are unfamiliar with the tax laws in that tax jurisdiction. In the event of a tax audit, professional legal guidance is crucial to maintain a consistent and defensible narrative that can be effectively utilised in potential litigation.

WELL-DRAFTED DOCUMENTS

Equally important are adequate contractual arrangements and well-drafted agreements. They can serve as contemporaneous evidence to support your organisation's tax position and claims in the event of disputes or investigations.

SUBSTANCE AND FORM

All changes on paper must be substantiated in actual operations. Ultimately, the best professional advice and legal documents will do little to support an organisation's tax position if they do not reflect reality. The alignment of substance and form is crucial.

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