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P.C. Appeal No. 31 of 1976

IN THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL

O N A P P E A L

FROM THE FEDERAL COURT OF MALAYSIA

B E T W E E N:

HOCK HENG COMPANY SDN BERHAD — Appellant

- and -

THE DIRECTOR GENERAL OF INLAND REVENUE — Respondent

CASE FOR THE RESPONDENT

10 1. The Appellant Company was at all material times resident in Malaysia and carried on the business of rubber dealing. Its head office was in Malaysia and it had a branch in Singapore. This branch constituted a "permanent establishment" and the Appellant Company was therefore subject to taxation in Malaysia, and, in respect of the profits of that branch, in Singapore. For the year of assessment 1968 it had admittedly suffered a loss of $538,335.00 attributable to the business
20 carried on by its Singapore establishment.

2. The sole issue raised by this appeal is whether, in computing its income chargeable to Malaysian Income Tax for the year of assessment 1968, the Appellant Company was entitled to deduct the said sum of $538,335.00.

3. It is accepted by the Respondent that the resolution of this issue depends upon the true construction of the Income Tax Act, 1967, and of the Double Taxation Relief (Republic of Singapore)
30 Order, 1966, (hereinafter referred to as the Double Taxation Order). The Double Taxation Order gave effect to arrangements contained in an Agreement between the Government of Malaysia and Singapore (hereinafter referred to as the Double Taxation Agreement).

4. The Double Taxation Order was brought into effect by virtue of section 45(1), Income

Tax Ordinance, 1947, and was in operation at the time of the coming into effect of the Income Tax Act, 1967. It will be the submission of the Respondent that by virtue of the provisions of paragraph 33 of the 9th Schedule of the Income Tax Act, 1967, the Double Taxation Order is to be deemed to have been made under theprovisions of Section 132(1) Income Tax Act, 1967. This provides that so long as an order made under its provisions remains in force the arrangements made by the Government for the avoidance of double taxation which are specified in the order shall have effect notwithstanding anything in any written law. The Respondent, therefore, submits that the arrangements provided for by the Double Taxation Agreement had effect in relation to tax for the year of assessment 1968 notwithstanding anything in any written law, which latter expression includes the Income Tax Act, 1967.

5. Article IV of the Double Taxation Order provides that the profits of a permanent establishment in Singapore through which a Malaysian enterprise carries on business in Singapore may be taxed in Singapore on so much of the profits of the Malaysian enterprise as are attributable to that permanent establishment. Furthermore the Article also provides that no further tax (i.e. further to any Singapore tax that may be imposed) shall be imposed in Malaysia in respect of profits of the permanent establishment which are remitted to Malaysia. As it is accepted that the Appellant's Singapore branch was a permanent eatablishment it follows that for the year of assessment 1968 these provisions applied to the Appellant's branch in Singapore.

6. It will be submitted by the Respondent that the effect of Article IV is that the profits of the Appellant company that are attributable to its establishment in Singapore are taxable in Singapore. And as it is expressly stated in paragraph 2 of the Double Taxation Order that the purpose of the Order is to afford relief from double taxation in relation to Malaysian Tax and Singapore Tax it is a necessary inference that the same profits are not to be taxable in Malaysia.

7. The essential purpose of the Double Taxation Agreement and Order was to ensure that no-one who had paid tax in Singapore should be required to pay further tax on the same profits

in Malaysia. When the Agreement and Order were made, tax was payable in Malaysia on income derived from abroad only in so far as that income was remitted to Malaysia; (s.10 of the Income Tax Ordinance 1947). Therefore Article IV only granted express exemption to such of those profits taxed in Singapore as were remitted to Malaysia.

The Income Tax Act 1967, however, purported to charge to tax all the income of a Malaysian company "from whereever derived". The Double Taxation Order continued in effect under the Income Tax Act 1967. The Respondents will submit that it would be manifestly absurd if, in respect of the profits of its Singapore establishment which had been taxed in Singapore, a Malaysian company was subject to further taxation in Malaysia if those profits were not remitted to Malaysia, while being entitled to relief if they were remitted; and that therefore, since the coming into force of the Income Tax Act 1967, the Double Taxtion Order must be construed as exempting from Malaysian tax all the profits of a Singapore permanent establishment. In other words, that permanent establishment is for the purposes of Malaysian tax to be treated as a separate entity, to which regard should not be had in computing the taxable income of the Malaysian company.

8. Article XVII provides that the laws of each contracting state shall continue to govern the taxation of income in that state except where express provision to the contrary is made in the agreement. It follows in the Respondent's submission that, as the profits of the Singapore business are by virtue of the agreement taxable only in Singapore and not in Malaysia, when the profits of the Appellant's business in Singapore are to be computed and assessed it is in accordance with the law of Singapore that the process is to be carried out.

9. It is the submission of the Respondent that where a taxpayer has made losses in the carrying on of his business that fact is only relevant, in the absence of special provisions, to the computation of the taxable profits of that business. Where, as in the present case, the losses were attributable to an establishment of the Appellants the profits of which fell to be assessed in

accordance with Singapore Law, it is only in the process of computing whether that Singapore establishment made any, and if any how much, taxable profits according to Singapore law that the losses attributable to the Singapore establishment are relevant. By virtue of s.43(2) of the Income Tax Act, 1967, in computing a company's aggregate income for any year losses fr m previous years are deducted from its statutory aggregate income from business sources only for that year, and in the absence of evidence to the contrary it is to be presumed that the law of Singapore is to the same effect. Thus the loss of $538,335 would in subsequent years have been deducted from the profits of the Singapore establishment in computing its aggregate income for the purposes of Singapore tax. 10

10. It has been the contention of the Appellant that in computing the profits of its business of rubber dealing for thepurposes of Malaysian income tax it is entitled to deduct the losses that are attributable to its Singapore establishment because of Section 3(a) Income Tax Act, 1967 tax is charged upon its "income from wherever derived". The Respondent accepts that if there were no double taxation agreement operative between Malaysia and Singapore the Appellant company would be liable to pay income tax in Malaysia upon "its profits from wherever derived"; that this would include its profits derived from Singapore as a result of the activities of its Singapore establishment, and that, to the extent that Malaysian law permitted the deduction of losses, suffered by the Singapore establishment could be taken into account. The calculation of the amount of the profits or losses derived from Singapore would in these circumstances be carried out in accordance with the law of Malaysia, whereas the loss of $538,335 in this case would have been computed in Singapore. 20 30 40

11. The Respondent will contend, however, that, because at the relevant time there was in operation between Singapore and Malaysia the Double Taxation Agreement of 1966, the effect of which was made part of the law of Malaysia by the Double Taxation Order, Section 3(a), Income Tax Act, 1967 must be read subject to the provisions of the Double Taxation Order because the Order was expressly said to have effect notwithstanding any written law. 50

12. In order to establish that it is entitled to deduct the loss of $538,335 in computing its income for the purposes of Malaysian Income Tax, the Appellants must rely on Section 44(2) Income Tax Act, 1967 which provides that in computing the total income for a year the aggregate income shall be reduced by deducting the amount of "any adjusted loss" for the basis period of that year. Adjusted loss is defined by s. 40 as follows :

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> "40. Subject tothis Act, where but for an insufficiency of gross income of a person from a business for the basis period for a year of assessment there would have been an amount of adjusted income of that person from the business for that period, the amount by which the total of all such deductions as would then have been allowed under the foregoing provisions of this Chapter in ascertaining that adjusted income exceeds his gross income from the business for that period shall be taken to be the amount of his adjusted loss from the business for that period".

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As the income of this company derived from its establishment in Singapore is not subject to tax in Malaysia, the conditions which bring this section into operation are not fulfilled and there cannot be an adjusted loss derived from an establishment the profits of which would not be taxable in Malaysia.

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13. The Respondent will further submit that the judgments of Chang Min Tat J. in the High Court and of Suffian L.P., and Lee Hun Hoe C.J. in the Federal Court were correct and that the reasoning contained in each of them was sound.

14. The Respondent therefore humbly submits that this Appeal should be dismissed for the following, among other

R E A S O N S

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(1) BECAUSE upon a true construction of Income Tax Act, 1967, and the Double Taxation Order, 1966, the provisions of Section 3(a) Income Tax Act, 1967, should be read subject to the provisions of the Double Taxation Order, 1966.

(2) BECAUSE upon a true construction of the Double Taxation Order, 1966, the income of the Appellant's establishment in Singapore for

the year of assessment 1968 was only taxable in Singapore and could not be taxed again in Malaysia.

(3) BECAUSE the losses suffered by the Appellant's establishment in Singapore were only relevant for the purposes of computing its profits in accordance with Singapore law, and could not also be taken into account in computing its income for the purposes of Malaysian tax.

(4) BECAUSE the judgments of the Federal Court and of the High Court were correct for the reasons contained therein and should be supported. 10

PATRICK MEDD

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HOCK HENG COMPANY SDN. BERHAD

Appellant

- and -

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Respondent

CASE FOR THE RESPONDENT

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