

**LIFTING THE CORPORATE VEIL:
DIRECTOR'S LIABILITY ON COMPANY'S TAX
DEBTS**

BY

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requirements for the degree of Masters in Comparative Law

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ABSTRACT

The company's law doctrine of separate legal entity and limited liability generally exempting the directors from being liable for their company's debts. However, the corporate veil has to be lifted to find the alter ego behind the lifeless company, and making the directors liable for the company's tax debts. This study examines the application of section 75 and section 75A of the Malaysian Income Tax Act 1967 in making directors jointly and severally liable for the taxes and debts of their companies while comparing to legislative provisions and best practices in another jurisdictions, particularly in Canada and Australia. It also investigates the existing application of the Malaysian tax law and the director's duties in the Companies Act 2016, with similar comparison to Canadian and Australian company laws and tax laws regarding the director duties and imposition of liability on directors for corporations tax debts.

This study utilizes a mixed qualitative approach comprising of two methodologies; firstly, library research of the existing laws, articles, books, journals, reports, studies and other information pertaining to tax law on director's duties and personal liability for company's tax debts and also tax law of Canada and Australia. This data constitutes the primary data for this research. Secondly, the data on implementation of legal actions against the directors in Malaysia for the company's tax debts are requested and collected from Jabatan Pungutan Hasil and Jabatan Teknologi Maklumat of the Inland Revenue Board of Malaysia (IRBM) headquarters in Cyberjaya as secondary data to support the theory of efficiency of this law in Malaysia.

خلاصة البحث

إن مبدأ قانون الشركة المتمثل في الكيان القانوني المنفصل والمسؤولية المحدودة يعني عمومًا المديرين من تحمل المسؤولية عن ديون شركاتهم. ومع ذلك، يجب رفع حجاب الشركة للعثور على الذات البديلة وراء الشركة التي لا حياة لها، وجعل المديرين مسؤولين عن ديون الشركة الضريبية. تبحث هذه الدراسة في تطبيق القسم 75 والقسم 75 أ من قانون ضريبة الدخل الماليزي لعام 1967 في جعل المديرين مسؤولين بالتضامن والتكافل عن ضرائب وديون شركاتهم أثناء المقارنة بالأحكام التشريعية وأفضل الممارسات في ولايات قضائية أخرى، لا سيما في كندا وأستراليا. كما أنها تحقق في التطبيق الحالي لقانون الضرائب الماليزي وواجبات المدير في قانون الشركات لعام 2016، مع مقارنة مماثلة لقوانين الشركات الكندية والأسترالية وقوانين الضرائب المتعلقة بواجبات المدير وفرض المسؤولية على المديرين لديون الشركات الضريبية. تستخدم هذه الدراسة نهجًا نوعيًا مختلطًا يتكون من منهجيتين؛ أولاً، بحث المكتبة عن القوانين الحالية والمقالات والكتب والمجلات والتقارير والدراسات وغيرها من المعلومات المتعلقة بقانون الضرائب على واجبات المدير والمسؤولية الشخصية عن ديون الشركة الضريبية وكذلك قانون الضرائب في كندا وأستراليا. تشكل هذه البيانات الأولية لهذا البحث. ثانيًا، يتم طلب البيانات المتعلقة بتنفيذ الإجراءات القانونية ضد المديرين في ماليزيا للديون الضريبية للشركة وتحصيلها من قسم تحصيل الإيرادات (Jabatan Pungutan Hasil) وقسم تقنية المعلومات (Jabatan Teknologi Maklumat) من مقر مجلس الإيرادات الداخلية الماليزي (IRBM) في سيرجايا كبيانات ثانوية لدعم نظرية كفاءة هذا القانون في ماليزيا.



APPROVAL PAGE

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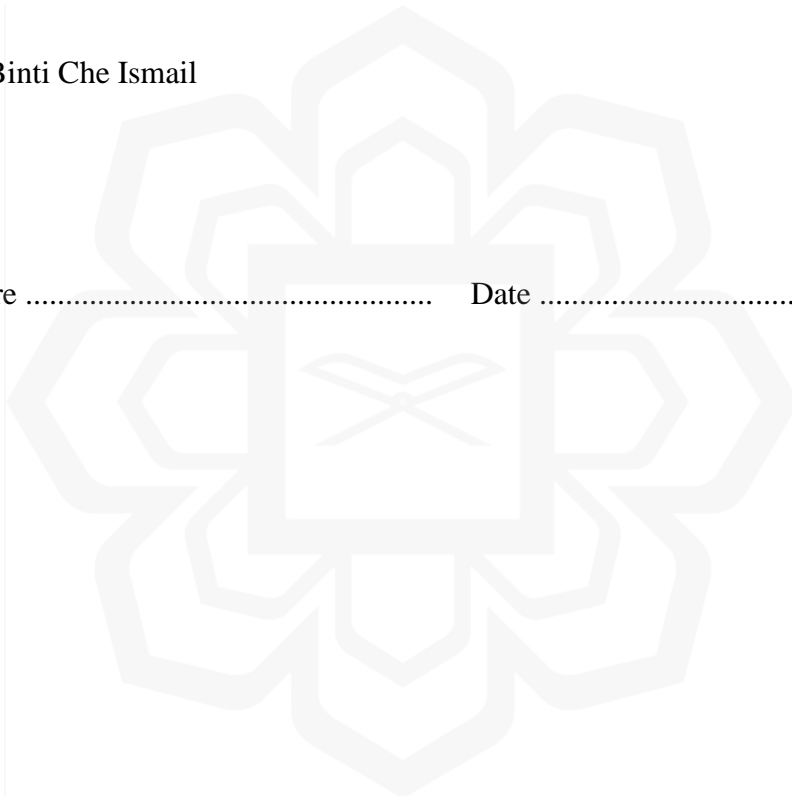
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DECLARATION

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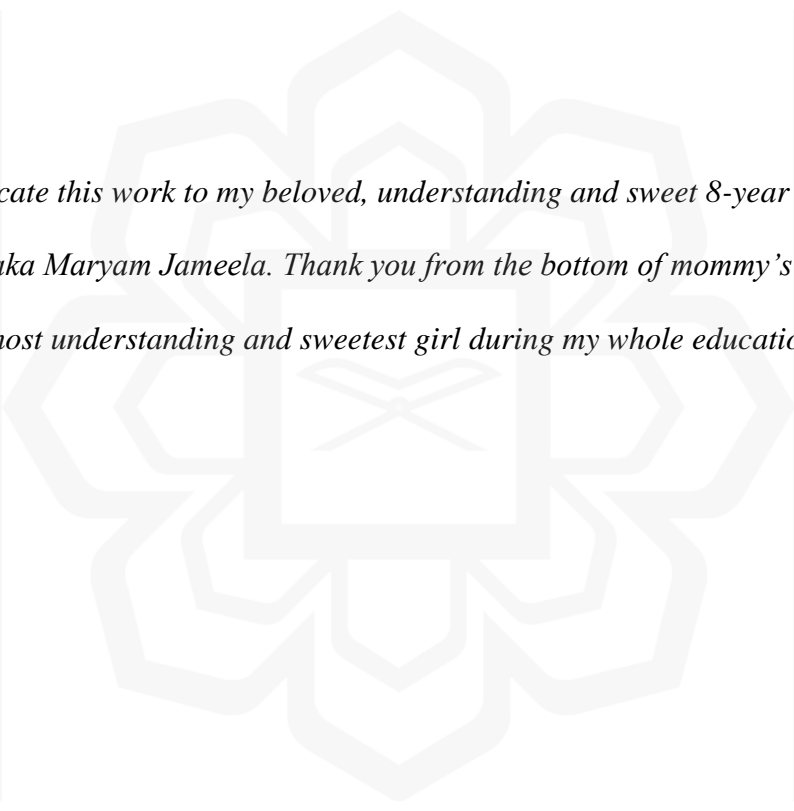
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*I dedicate this work to my beloved, understanding and sweet 8-year old daughter,
Chempaka Maryam Jameela. Thank you from the bottom of mommy's heart for being
the most understanding and sweetest girl during my whole educational journey.*

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Employment Insurance Act

Australia

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Income Tax Assessment Act 1936
Income Tax Assessment Act 1997
Taxation Administration Act 1953

LIST OF ABBREVIATIONS

| | |
|-----------|--|
| ACA 2001 | Australian Corporations Act 2001 |
| ATO | Australian Taxation Office |
| CBCA | Canada Business Corporations Act |
| CCM | Companies Commission of Malaysia |
| CA 2016 | Companies Act 2016 (Malaysia) |
| CRA | Canada Revenue Agency |
| EPF | Employees Provident Fund |
| EPFA 1991 | Employees Provident Fund Act 1991 |
| IRBM | Inland Revenue Board of Malaysia |
| ITA 1967 | Income Tax Act 1967 (Malaysia) |
| ITA | Income Tax Act (Canada) |
| ITAA 1936 | Income Tax Assessment Act 1936 (Australia) |
| ITAA 1997 | Income Tax Assessment Act 1997 (Australia) |
| ITDR 1994 | Income Tax (Deductions from Remuneration) Rules 1994 |
| OBCA | Business Corporations Act, 1982 (Ontario) |
| TAA 1953 | Taxation Administration Act 1953 |

CHAPTER 1

INTRODUCTION

1.1 INTRODUCTION

Imposing personal liability against the company directors for the company's taxes due and payable may be regarded as draconian. The doctrine of separate legal entity and limited liability in the company laws might be impugned. The doctrine of separate legal entity in corporation is preceded from the case of *Salomon v A. Salomon Ltd.*¹ where the House of Lords held that the company alone is liable for its debts and its legal entity is separate from its members, controllers and directors. On that score, making a director responsible for the company's tax offences would also mean the corporate veil is lifted to find the alter ego behind the lifeless company.

This study aims at making functional comparisons on tax enforcement against the company director for the company's tax debts and offences in Malaysia with other jurisdictions, especially in Australia and Canada. It purported to give a better understanding and analysis on the legal provisions, pre-requisites for the implementation and execution of personal liability against the company directors on the company's tax debts and offences in those jurisdictions. It also aims to improve the Malaysian tax law in relation to the imposition of director's liability and adapting the Malaysian laws by filling in the gap through analyzing the best practices in Canada and Australia. This study is significant for our future tax enforcement

¹ [1897] AC 22.

system, widening tax coverage and liability to curb tax leakage, avoidance and evasion, specifically for corporate taxes.

The comparison to Canada and Australia is made since both are commonwealth countries that apply common law principles. The doctrine of judicial precedents is practised in both countries similar to Malaysia. Canada is a bijural² state where both common law and civil law coexist and the principles of common law applies throughout Canada in all matters of public law including criminal law and administrative law.³ In Canada tax law, the director's personal liability for the company's debts have been imposed since 1970s and the long experience would benefit Malaysian taxation.

There have been recent resurgences of recovery cases against the defaulted companies in paying taxes and the Inland Revenue Board of Malaysia (IRBM) has taken various measures to secure payment of tax by the companies through civil and criminal suits. However, the final resort of legal action that can be taken after judgment obtained against the company is to wind up the company, if no payment or insufficient tax has been paid. The IRBM opts to lift the corporate veil by going against the directors cum shareholders of the company as registered in the Registration of Companies statement provided and kept by the Companies Commission of Malaysia (CCM) to recover the tax due and payable by the company. Through the Income tax Act 1967 (ITA 1967), the IRBM can extend its power to limit the directors' limited liability defence on tax matters in order to recover their company's tax debts.

² Bijural is defined as the coexistence of two legal traditions within a single state where the common law and civil law coexist in Canada and hence, Canada is a bijural country. Accessed via <https://www.justice.gc.ca/eng/rp-pr/csj-sjc/harmonization/hfl-hlf/b2-f2/bf2.pdf>.

³ Introduction to the country's legal system (Canada) accessed via Canada Justice website at <http://canada.justice.gc.ca/eng/dept-min/pub/just/> on 20.01.2021.

1.2 BACKGROUND OF THE STUDY

Director's liability in tax arises when the corporate veil is pierced, lifted or removed. A director is responsible for acting in good faith with a certain degree of care in a situation the way a normal, law-abiding director would act in a similar situation in making decisions and acts or omissions for his company,⁴ failing which, the limited liability will be removed and the corporate veil will be pierced, hence, making the director's liable for the decisions, acts or omissions.

'Director' in tax is defined under Section 2 of the ITA 1967 which includes a person appointed as a director regardless of whether he performs the functions as director or not (*de jure* or *de facto* director), or the manager of the company, or his associates, having shareholding of at least 20% of the ordinary share capital of the company. 'Liability' in tax is defined as the amount of tax owed by an individual, corporation or other entity to the tax authority⁵.

'Director's liability' in the scope of this study is the liability imposed on the director when the company or corporation fails to fully pay the amount of tax assessed on the company's income as in civil liability or when the company as an employer fails to adhere certain tax rules and regulations in which the director is criminally liable for the company's conducts. For instance, the company fails to pay the amount of tax assessed for a certain year, and the IRBM can initiate civil action against the director for recovery of tax owed by the company. Whereas, in another instance, the company deducts certain amount from the employees' wages for purposes of monthly tax instalments, but then failed to remit the amount deducted to

⁴ The UpCounsel Team, "Officer and Director Liability", via UpCounsel website at <https://www.upcounsel.com/liability-of-company-directors#officer-and-director-liability> (accessed on 12.5.2021).

⁵ The Investopedia Team, "Definition of tax liability", via Investopedia website at <https://www.investopedia.com/terms/t/taxliability.asp> (accessed on 12 May 2021).

the IRBM within the prescribed period and manners, in which the director can be made criminally liable for the company's failure to remit.

Director's liability is defined under Subsection 75A(1) of the ITA 1967 where a director is jointly and severally liable for the company's taxes owed to the government or any debt due and payable by the company acting as an employer under any rules pursuant to Section 107 of the ITA 1967. Both tax or debt can be recovered by the IRBM on behalf of the Government of Malaysia under Section 106 of the ITA 1967. The section provides the main prerequisite condition i.e. the person must be a subsisting director of the company during the period in which the tax or debt is liable to be paid by the company.

The IRBM has initiated legal enforcement against company directors since the introduction of section 75A in 2002 to curb corporate tax leakages and avoidance. Civil recovery actions have been actively pursued against the director for his company's tax debts in 2015 by the IRBM till to date for the government's observance that the directors are frequently fled away from the company's liabilities to tax, leaving the company becomes insolvent and then, wound up and absolved for good. The corporate veil and limited liability are removed when it comes to recovery of company taxes especially when the directors use the company as a vehicle for the avoidance of liability. From 2013 till May 2021, there are 6610 civil cases amounting to a sum of RM3,772,342,399.52 tax debts filed by the IRBM against the company directors in Klang Valley seeking to recover the tax monies owed by the company to the IRBM. A total of 28,313 section 104 certificates⁶ banned directors from fleeing

⁶ S 104 of the Income Tax Act 1967 (Act 53) is a provision on travel ban for individual tax defaulters, including the qualified directors under Section 75A, in which a travel ban certificate is issued on the defaulters from going in or out of Malaysia.

the country has been issued since 2012 up to May 2021 for Klang Valley tax files.⁷ Those initiatives have at least help to increase revenue collection rate each year and alert taxpayers on payment of taxes.

1.3 PROBLEM STATEMENT

The general rule is that, a director cum shareholder has liability limited to his shares in the company and the company has a separate legal entity from its members. However, the principle of limited liability and the doctrine of separate legal entity can be exempted by the court by lifting the corporate veil, in order to find justice and the real culprit behind the company's wrongdoings.

The joint and several liability concept of Malaysian tax law makes company directors liable in all aspects of tax offence and non-payment of tax, mainly in the ITA 1967 and its subsidiary rules and regulations. For example, a director can be made jointly and severally liable under Section 75 if the company fails to remit the monthly tax deductions deducted from the employees' salaries under the Income Tax (Deduction from Remuneration) Rules 1994 (ITDR 1994).⁸ A company director can also be made liable if his company fails to submit its annual tax return form on the prescribed period⁹ or failure to pay the full amount of tax-debts for his company's failure to pay its income tax assessed under the ITA 1967.¹⁰ Basically, a company director can be made jointly and severally liable for all his company's acts and omissions on tax matters under the sun, unlike other jurisdictions such as the UK, Australia and Canada where the director's liability in tax is only limited to the

⁷ Source from *Jabatan Pungutan Hasil* (JPH) and *Jabatan Undang-Undang* (JUJ) of the IRBM Head Quarters, Cyberjaya.

⁸ Income Tax (Deductions from Remuneration) Rules 1994 [P.U.(A) 507], r 13.

⁹ Income Tax Act 1967 (Act 53), s 112.

¹⁰ *Ibid.*, s 103.