



ANTI-TAX AVOIDANCE LAW IN MALAYSIA:
A COMPARATIVE STUDY

BY

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ABSTRACT

Tax evasion and avoidance pose a serious problem for the tax system and the response by the governments is to control it. Tax avoidance is used to denote the reduction of tax liability through legal means whereas tax evasion involves non payment of tax through violation of law. The focus of this thesis is on tax avoidance rather than on tax evasion. It is important to understand the concepts of “tax evasion”, “tax avoidance” and “tax mitigation” in the study of tax avoidance. With these distinctions between evasion, avoidance and mitigation, the problem of tax avoidance and its causes can be identified in the countries under study. This research examines the legislative, judicial and administrative measures adopted by Malaysia, UK, Australia and India to tackle tax avoidance and evasion. The question this thesis has to address is whether current methods of dealing with tax avoidance by Malaysia are adequate and satisfactory and what, if any, other measures might be taken based on the experiences of UK, Australia and India. A quick answer is “yes” but further improvements to the general anti-avoidance rule (section 140 of the ITA 1967) should be considered based on the Australian anti-avoidance rule and certain additional measures from the countries under study can also be adopted. It is not possible to eradicate tax avoidance totally. Instead, there is a need to find a right balance so that taxes are not unduly avoided and the legitimate interests of taxpayers in their commercial and private affairs are not unnecessarily hindered. On the payment of *zakāt*, there should be no avoidance because of its spiritual significance in Islam as the third pillar. In modern times, various sanctions and administrative measures are used to compel payment of *zakāt*. In cases where Muslims are required to pay both *zakāt* and income tax, a rebate of the payment of *zakāt* against tax payable should be given as an incentive to pay *zakāt*.

خلاصة البحث

يشكل التهرب الضريبي مشكلة حقيقية للنظام الضريبي تتعامل معها الحكومات بمحاولة يشكل التهرب والتجنب الضريبي مشكلة حقيقية للنظام الضريبي تتعامل معها الحكومات بمحاولة السيطرة عليها. يستخدم مصطلح التجنب الضريبي للإشارة إلى خفض الدين الضريبي من خلال وسائل قانونية، بينما ينطوي التهرب الضريبي على عدم دفع الضرائب من خلال إنتهاك القانون. تركز أطروحتنا هذه على موضوع التجنب الضريبي وليس على التهرب الضريبي. إنه من المهم بمكان فهم ماتعنيه مصطلحات "التهرب الضريبي" و "التجنب الضريبي" و "التخفيف الضريبي" عندما نتناول موضوع التجنب الضريبي. بهذه الفوارق بين التجنب والتهرب والتخفيف الضريبي ، يمكن تحديد مشكلة التهرب من دفع الضرائب وأسبابها في الدول الخاضعة للدراسة. يتناول هذا البحث التدابير التشريعية والقضائية والإدارية التي تتبناها ماليزيا والمملكة المتحدة وأستراليا والهند لمعالجة التجنب والتهرب الضريبي. إن السؤال الذي يجب أن تطرحه هذه الأطروحة هو ما إذا كانت الوسائل الحالية التي تعالج التجنب الضريبي في ماليزيا مناسبة ومرضية، وماهي التدابير الأخرى، إن وجدت، التي يمكن الأخذ بها بناء على تجارب المملكة المتحدة وأستراليا والهند. يمكننا الإجابة سريعاً بـ "نعم"، ولكن لا بد أن نأخذ بعين الإعتبار مزيداً من التطوير للقانون العام لمكافحة التجنب الضريبي (المادة 140- قانون ضريبة الدخل 1967) بناء على قانون مكافحة التجنب الضريبي الأسترالي، كما يمكن تبني تدابير إضافية بعينها إتخذتها الدول موضع الدراسة. قد لا يكون من الممكن القضاء التام على التجنب الضريبي، وعوضاً عن ذلك تبدو الحاجة ماسة لإيجاد نوع من التوازن الحقيقي بحيث لا تكون الضرائب متجنبنة بدون مبرر وألاً تتعرض المصالح المشروعة لدافعي الضرائب في شؤونهم التجارية والخاصة لعراقيل لا داعي لها. فيما يتعلق بدفع الزكاة، لا يجب أن يكون هناك تهرب من دفعها نظراً لأهميتها الروحانية في الإسلام كونها الركن الثالث. في الوقت الحديث، تُتخذ عقوبات وتدابير إدارية متعددة لفرض دفع الزكاة. ففي الحالات التي يتعين على المسلمين دفع كلٍ من الزكاة وضريبة الدخل يجب خصم الزكاة المدفوعة من الضريبة.

APPROVAL PAGE

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DECLARATION

I hereby declare that this thesis is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

Kuek Tee Say

Signature

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INTERNATIONAL ISLAMIC UNIVERSITY MALAYSIA

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A COMPARATIVE STUDY**

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A.T.C.	Annotated Tax Cases, from 1922-1973
AC	Law Reports (Appeal Cases) from 1891
AIR	All India Reports
AITR	Australian Income Tax Reports
ALJR	Australian Law Journal Reports
All ER Rep	All England Law Reports Reprint
All ER	All England Law Reports, from 1936
ALR	Australian Law Reports
App. Cas	Appeal Cases
ATC	Australian Tax Cases, from 1969
ATD	Australian Tax Decisions, from 1930-1969
ATR	Australian Tax Review
IBFD	International Bureau of Fiscal Documentation
CATA	Commonwealth Association of Tax Administrators
C.I.R.	Commissioners of Inland Revenue
C.J.	Chief Justice
CA	Court of Appeal
Ch	Law Reports, Chancery Division, from 1891 (England)
Ch. App	Chancery Appeal
Ch. D	Law Reports, Chancery Division, 1875-1890 (England)
CLJ	Current Law Journal (Malaysia)
CLR	Commonwealth Law Reports, from 1904 (Australia)
div./divs	division/divisions
DGIR	Director General of Inland Revenue (Malaysia)
et al.	(et alia): and others
etc	(<i>et cetera</i>): and so forth
F.C. of T	Federal Commissioner of Taxation (Australia)
F.C.J.	Federal Court Justice (Malaysia)
FC	Federal Court (Malaysia)
GAAR	General Anti-Avoidance Rule
HKTC	Hong Kong Tax Cases
HMRC	Her Majesty's Revenue & Customs
Ibid.	(<i>ibidem</i>): in the same place
Id	(<i>idem</i>): the same below
ITA	Income Tax Act
J.C.	Judicial Commissioner
KB	Law Reports, King's Bench Division, from 1891 (England)
L.J.; L.JJ	Lord Justice; Lord Justices
LJQB	Law Journal Reports, Queen's Bench
M.R.	Master of the Rolls

MLJ	Malayan Law Journal
MSTC	Malaysia and Singapore Tax Cases, CCH
MTJ	Malayan Law Journal
OECD	Organisation for Economic Co-operation and Development
PC	Privy Council
P.B.U.H.	Peace Be Upon Him
QB	Law Reports, Queen's Bench Division, from 1875 (England)
QBD	Queen's Bench Division
S.C.J.	Supreme Court Judge
SAAR	Specific Anti-Avoidance Rule
SC	Supreme Court
Sch.	Schedule
STC	Simon's Tax Cases (England)
Trans.	Translator/translated by
TC	Tax Cases, from 1875 (England)
TLRC	Tax Law Review Committee
UK	United Kingdom
UKHL	United Kingdom House of Lords
USA	United States of America
WLR	Weekly Law Reports, from 1953 (England)

CHAPTER 1

INTRODUCTION

1.1 PRELIMINARY

Tax evasion and tax avoidance are universal problems. As stated in the South African Revenue Service Discussion Paper on Tax Avoidance, the growth in tax avoidance activity is a worldwide concern and “has been growing internationally during the past ten years”.¹ It is estimated that developing countries lose nearly US\$500 billion of tax revenue each year because of tax avoidance and evasion. Around US\$124 billion of this, bigger than the annual overseas aid budget of UK, is attributed to tax havens. UK loses about £100 billion a year. Unofficial estimates suggest that £18.5 billion of this may relate to the use of tax havens. The United States is estimated to be losing about US\$345 billion of tax revenues each year, around US\$100 billion of which relates to tax havens.²

Traditionally, tax evasion was regarded as criminal and avoidance as lawful. Tax avoidance is used to denote the reduction of tax liability through unacceptable legal means, such as taking benefit of loopholes in taxing statutes, whereas, tax evasion involves non-payment of tax in violation of law.³ However, not all tax avoidance is acceptable to the Tax Authority especially when it comes to artificial transactions with no commercial justification. What is it that distinguishes

¹ See South African Revenue Service, *Discussion Paper on Tax Avoidance*, Praetoria: Law Administration, SARS, 2005, at 3, 16, 19.

² Helene Scholl, “Clamping down on the Tax Dodgers,” (European CEO), at <http://www.europeanceo.com/magazine-articles/article538.html> viewed on 29 November 2009.

³ Evasion is caused by concealment of income which generally covers: concealing any transaction in which there is liability to pay tax wholly or partly; and showing any expenditure for the sake of claiming deduction which has not been incurred. It is intentional. See Jeyapalan Kasipillai, *A Comprehensive Guide to Malaysian Taxation under Self-Assessment System*, McGraw-Hill (Malaysia) Sdn. Bhd., 4th edn., 2009, at 554.

unacceptable avoidance and legitimate mitigation (planning) when both involve reducing tax liability? In order to distinguish them, rules have been incorporated into law to counter types of avoidance which legislature disapproved and these rules are termed as “anti-avoidance provisions”. Abusive tax avoidance, which defeats the intention of Parliament and entered into solely or mainly for the purpose of obtaining a tax benefit under the legislation, should not be given their desired effect.⁴ The very idea of anti-tax avoidance law came into being because excessive tax avoidance will adversely affect the revenue yield of the state. It is for this reason that the law draws a line between allowable and non-allowable tax avoiding transactions or arrangements. States are still making strategies not to allow certain transactions and arrangements. Beside legislative intervention, judicial and administrative measures are also there to counteract tax avoidance schemes. In this thesis, the scholar is concerned only with the issues of tax avoidance and shall not address the prevention and control of tax evasion.

Tax planning is concerned with the organisation or structuring of a taxpayer’s affairs so that they give rise to the minimum tax liability within the law without resorting to the type of artificial tax arrangements.⁵ It follows both the letter and the spirit of the law in that a taxpayer takes advantage of an option provided by the law and actually suffers an economic consequence that was intended by the Parliament.⁶

The distinction between tax evasion and tax planning is clear cut in that the former is illegal and the latter legal and allowed to be practised by taxpayers. As for

⁴ The UK Tax Law Review Committee described tax avoidance as any “action taken to reduce or defer tax liabilities in a way that Parliament plainly did not intend or could not possibly have intended had the matter been put to it.” See Tax Law Review Committee, *Tax Avoidance, IFS Commentary No. 64*, The Institute for Fiscal Studies, 1997, at 3.

⁵ See Jeyapalan Kasipillai, *Tax Avoidance in Malaysia: Principles and Cases*, CCH Asia Pte Limited, 2010, at 7.

⁶ See *IRC v Willoughby* [1997] 4 All ER 65, 18.

tax avoidance, the purpose is to seek a reduction in liability by merely complying with the letters of the law. Unlike tax planning, the taxpayer seeks to avoid tax by resorting to artificial or contrived tax schemes, which is devoid of business purpose. This is clearly not acceptable and most countries will strike down tax avoidance of this nature. Therefore, it is important to distinguish these three concepts so that the strategies to counteract tax evasion and avoidance will be clear and effective.

1.2 BACKGROUND OF THE RESEARCH

As a broad definition, tax avoidance can be regarded as means adopted to reduce or defer tax liabilities in a way that Parliament clearly did not intend. The subject of tax avoidance is very different and highly controversial because it may be a lawful activity, but if it comes under the purview of anti-tax avoidance law, it is considered to be tainted with illegality and not allowed (e.g. false transactions). There are several views as to the nature and extent of the problem, including whether tax avoidance is a “problem” at all. Further, it is impossible to quantify (either in the numbers of taxpayers involved or in amount of loss) the extent of tax avoidance and tax evasion in a country because tax avoidance and evasion activities are mostly practised secretly. In addition, there are numerous difficulties involved in the process of determining the amount of tax loss from these activities. Any such estimate can only be a guess and would involve an element of subjectivity. Whether the amount can be determined accurately or not, every country has adopted measures to curb tax avoidance since it is an activity that distorts taxpayers’ behaviour and affects the integrity of a tax system. Governments have made proactive efforts to curb tax avoidance in a number of ways.

Generally, the existing responses for countering avoidance are judicial, legislative, and administrative measures. The primary strategy and initiative used to

deal with tax avoidance and evasion is through legislative control. This has to do with the nature and design of legal provisions, which will help combat abusive tax arrangement. Therefore, in all tax legislations now, there are anti-avoidance provisions (based on them certain transactions might not be accepted by taxing authorities) and penal provisions for tax evasions. In many countries, including Malaysia, there are general anti-avoidance provisions and specific provisions to curb avoidance. The fundamental purpose of general anti-avoidance rules (hereinafter, GAARs) and specific anti-avoidance rules (hereinafter, SAARs) is to ensure an effective curb on tax avoidance. GAARs may be defined as a broad spectrum of rules that have an effect of deterring or counteracting the use of artificial transactions to arrange the tax affairs by the taxpayer for obtaining an undue tax advantage. It provides an overriding protection against tax avoidance that otherwise escape the various SAARs available in the taxing statutes. On the hand, SAARs are applicable in particular contexts and are specifically designed as mechanical rules to counteract specific tax avoidance transaction. In countries where there are no GAARs, courts have developed a variety of anti-avoidance rules to curb tax avoidance by denying taxpayers the beneficial consequences resulting from a literal reading of the legislation. Anti-avoidance doctrines are applied as interpretative aids in the context of deciding tax disputes. Cases relating to tax avoidance and tax planning have typically constituted one of the major areas of tax litigation in many of these regimes.

Simplicity is a desirable feature of a good tax system because it facilitates both administration and compliance. However, tax avoidance is a threat to legislative simplicity. Countering avoidance can add considerably to prolixity and complexity when the response to a perceived loophole is to introduce a specific anti-avoidance provision to block it. This may even create new avoidance opportunities by acting as

a “road map” for tax planners. A spiral develops in which the blocking of one loophole is followed by the identification of another and so on. In addition, because it may be some years before the courts finally pronounce on a scheme’s success or not, legislature continues to change the law pre-emptively to avoid the loss of revenue.

The possibility of potential avoiders exploiting weaknesses in the legislation causes the draftsmen and policy makers to anticipate every eventuality and to make the legislation as avoidance-proof as possible. This approach is common to all countries. It is practically impossible to eradicate tax avoidance totally. However, efforts are continually made by the draftsmen to deal with the infinite variety and rapidly changing pace of tax avoiding activities. As such, anti-tax avoidance measures complicate tax legislations. Inevitably, this leads to complexity, uncertainty and increases the compliance costs for taxpayers.

Extensive and complex provisions may blur rather than focus the scope of provisions thereby causing uncertainty. Taxpayers prefer narrow and precisely drafted provisions to provide the certainty that they need, and not complex and unclear provisions. In the context of tax planning, it will help taxpayers to plan their tax affairs in such a way as to avoid being caught by a particular tax avoidance provision. The other extreme action taken by governments would be to draft anti-avoidance measures broadly. But this may affect innocent transactions which may require administrative concessions to deal with them.⁷ Ultimately, it is a question of balance.

The countries chosen for comparison in this thesis are UK, Australia and India. There are reasons for choosing these countries for comparative study purposes. UK is chosen as one of the countries for comparison as the Judiciary in UK has taken the lead in drawing a line between lawful and unlawful avoidance. Next, Australia is

⁷ In this context, the Malaysian tax authorities have provided guidance to taxpayers through the issuing of public rulings, advance rulings, and guidelines.

chosen because the Malaysian general anti-avoidance rule (s. 140) is based on the Australian law, although not exactly similar. Lastly, India is chosen because it is a developing nation and its tax anti-avoidance law is quite well developed.

Malaysia and Australia have adopted general anti-avoidance provision to curb tax avoidance. However, India and UK do not have such a general provision and mainly have to rely on judicial principles or to enact specific anti-avoidance provisions.⁸ The enactment of precisely targeted statutory provisions is the traditional way of countering avoidance in both the countries. Several Finance Acts in UK and India for many years have enacted a long list of specific anti-avoidance measures.⁹ Increasingly, various countries have now legislated specific anti-avoidance provisions targeted on particular group of taxpayers dealing in shares and lands.

Experiences in other common law countries that have adopted GAAR indicated the limitations of using such provisions. The provisions remain subject to judicial interpretation and it would be wrong to attempt to exclude the jurisdiction of the courts. The justification for a statutory general anti-avoidance rule is that there are limits to legislative language and the capacity for human prediction. Generally, legislators cannot foresee all forms of tax avoidance schemes contrived by taxpayers and so have continued to rely on them. The experience of common law countries indicated that a statutory general anti-avoidance provision is not a panacea to tax avoidance.

⁸ India is supposed to introduce the GAAR in 2011 but at this point of writing, it has not been approved by the Indian Parliament yet. In UK, no decision has been made to introduce a GAAR and the role of the judiciary in alleviating tax avoidance continues to be more significant than the legislature.

⁹ The previous Chancellor of the Exchequer for the United Kingdom, Gordon Brown, has rejected a general anti-avoidance rule as too onerous. See Richard Brooks, "Clegg tackles Brown over tax gap investigation," (The Guardian), at <<http://www.guardian.co.uk/business/tax-gap-blog/2009/feb/04/5>> viewed on 5 January 2012. However, a study group commissioned by the UK Government in December 2010 and led by Graham Aaronson QC has recommended that a narrowly focussed GAAR be introduced into UK tax law. To date, no GAAR has been introduced by the UK government.