TAX AVOIDANCE: THE SCOPE AND EFFECT OF SECTION 140 OF THE INCOME TAX ACT 1967

There is an important distinction between tax evasion and tax avoidance. Tax evasion refers to all those activities deliberately undertaken by a taxpayer to free himself from tax which the law charges upon his income, for example, the falsification of returns, books and accounts or the suppression of some material facts.[1] These schemes are illegal and are subject to very heavy and severe penalties.[2] To constitute evasion there must be an intention to deceive.

Tax avoidance, on the other hand, usually denotes that the taxpayer has arranged his affairs in such a legal manner that he has either reduced his income or that he has no income on which tax is payable. No obligation rests upon a taxpayer to pay a greater tax than is legally due under the taxing Act and a taxpayer is not debarred from entering into a *bona fide* transaction which has the effect of avoiding or reducing liability to tax, provided there is no provision in the law designed to prevent the avoidance or reduction of tax. This is clearly brought out by the following dicta:

> "Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax."[3]

> "No man in this country is under the smallest obligation, moral or other, so to arrange his legal relations to his business or to his property as to enable the Inland Revenue to put the largest possible shovel into his stores. The Inland Revenue is not slow — and quite rightly — to take every advantage which is open to it under the taxing statutes for the purposes of depleting the taxpayer's pocket and the taxpayer is, in like manner, entitled to be astute to prevent, as far as he honestly can, the depletion of his means by the Revenue."[4]

The above principles provide a taxpayer with the right and freedom to arrange his activities in a manner he would not otherwise have contemplated.

[1] See s. 114 of the Malaysian Income Tax Act, 1967 (Act 53 Revised — 1971).

[2] *Ibid.*

[3] *Inland Revenue Commissioners* v. *Duke of Westminster* [1963] A.C. 1 at p. 19 *per* Lord Tomlin.

[4] *Ayrshire Pullman Motor Services and D.M. Ritchie* v. *Inland Revenue Commissioners* (1929) 14 T.C. 754 at pp. 763-764 *per* Lord Clyde.

However, it must not be supposed that the courts encourage legal avoidance. The attitude of the courts towards the legal avoidance of tax seems to have undergone a change from the time when Lord Sumner regarded the practice as incurring 'no moral censure'[5] to the time when Viscount Simon characterised such activities as being neither 'a commendable exercise of ingenuity nor . . . a discharge of the duties of good citizenship.'[6] Matters have not rested at this point however, for Lord Reid took up this whole question in *Greenberg* v. *Inland Revenue Commissioners*[7] to make the telling observation that:

> "We seem to have travelled a long way from the general and salutary rule that the subject is not to be taxed except by plain words. But I must recognise that plain words are seldom adequate to anticipate and forestall the multiplicity of ingenious schemes which are constantly being devised to evade taxation. Parliament is very properly determined to prevent this kind of tax evasion and if the courts find it impossible to give very wide meanings to general phrases, the only alternative may be for Parliament to do as some other countries have done, and introduce legislation of a more sweeping character which will put the ordinary well-intentioned person at much greater risk than is created by a wide interpretation of such provision as those which we are now considering."[8]

However, perhaps the last word on the subject belongs to Lord Simon of Glaisdale, who in *Ransom* v. *Higgs*[9] argued for the adoption of a strict approached to the interpretation of taxation statutes on the basis that whilst:

> "It may seem hard that a cunningly advised taxpayer should be able to avoid what appears to be his equitable share of the general fiscal burden and cast it on the shoulders of his fellow citizens . . . [F]or the courts to try to stretch the law to meet hard cases . . . is not merely to make bad law but to run the risk of subverting the rule of law itself."[10]

In essence, the courts' approach to the problems of tax avoidance reduces itself to endeavouring to accord to the subject the freedom to organise his affairs as he sees fit without jeopardising the interests of the revenue.

Tax avoidance can be seen as a means by which taxpayers in the upper income groups attempt to move the burden of tax from their shoulders on to the shoulders of other taxpayers by the use of technical tax avoidance

[5] *Levene* v. *Inland Revenue Commissioners* [1928] A.C. 217 at p. 227; see also Lord Tomlin in *Inland Revenue Commissioners* v. *Duke of Westminster* [1963] A.C. 1 at p. 19.

[6] *Latilla* v. *Inland Revenue Commissioners* [1943] A.C. 377 at p. 381.

[7] [1972] A.C. 109.

[8] *Id.*, at p. 137. This view was endorsed by Lord Wilberforce in *Inland Revenue Commissioners* v. *Joiner* [1957] 3 All E.R. 1050 at p. 1055.

[9] [1974] 3 All E.R. 949.

[10] *Id.*, at p. 969.

devices. These affluent taxpayers have the greatest incentives, opportunities and ability for avoidance because they are subjected to high tax rates and have the means of hiring expert advice.

Tax avoidance has been described by Wheatcroft as 'the art of dodging tax without actually breaking the law'[11] and by Flesh as 'the lawfully carrying out of a transaction which was either entered into, or which took a particular form, for the purpose of minimising taxation.'[12] However, the above description of tax avoidance by Wheatcroft may be misleading in the light of section 140 of the Income Tax Act, 1967[13] which says clearly that transactions which defeat or avoid any liability imposed by the Act may be disregarded or varied by the Director-General of Inland Revenue for tax purposes. Tax avoidance manifestly does break the law.

Section 140 of the Malaysian Income Tax Act, 1967,[14] the main anti-tax avoidance section at present, reads as follows:

> 140 (1) The Director-General, where he has reason to believe that any transaction has the direct or indirect effect of —
>
> (a) altering the incidence of tax which is payable or suffered by or which would otherwise have been payable or suffered by any person;
>
> (b) relieving any person from any liability which has arisen or which would otherwise have arisen to pay tax or to make a return;
>
> (c) evading or avoiding any duty or liability which is imposed or would otherwise have been imposed on any person by this Act; or
>
> (d) hindering or preventing the operation of this Act in any respect,
>
> may, without prejudice to such validity as it may have in any other respect or for any other purpose, disregard or vary the transaction and make such adjustments as he thinks fit with a view to counter-acting the whole or any part of any such direct or indirect effect of the transaction.
>
> (2) In exercising his powers under this section, the Director-General may —
>
> (a) treat any gross income from any source of any person either as the gross income and source of any other person or, where the gross income is that of a controlled company, as having been distributed to any member (within the meaning of section 139(7)) of that company;
>
> (b) make such computation or recomputation of any gross income, adjusted income or adjusted loss, statutory income, aggregate income, total income or chargeable income of any person or persons as may be necessary to revise any person's liability to tax or impose any liability

[11] G.S.A. Wheatcroft, 'The Attitude of the Legislature and the Courts to Tax Avoidance' (1955) 18 *Modern Law Review* 209.

[12] M.C. Flesh, 'Tax Avoidance — The Attitude of the Courts and the Legislature' (1968) 21 *Current Legal Problem* 215.

[13] Act 53 (Revised — 1971).

[14] Act 53 (Revised — 1971). All references to 'the Malaysian Act' or 'the 1967 Act' hereinafter will be to the Malaysian Income Tax Act, 1967.

to tax on any person in accordance with his exercise of those powers; and

(c) make such assessment or additional assessment in respect of any person as may be necessary in consequence of his exercise of those powers, nullify a right to repayment of tax or require the return of a repayment of tax already made.

(3) Without prejudice to the generality of the foregoing subsections, the powers of the Director-General conferred by this section shall extend —

(a) to the charging with tax of any person or persons who but for any adjustment made by virtue of this section would not be chargeable with tax or would not be chargeable with tax to the same extent; and

(b) to the charging of a greater amount of tax than would be chargeable but for any such adjustment.

(4) Where in accordance with this section the Director-General requires from a person the return of the amount of a repayment of tax already made —

(a) the Director-General shall give that person a notice of that requirement and the notice shall be treated as a notice of assessment for the purpose of any appeal therefrom, the provisions of Chapter 2 Part VI applying with any necessary modifications; and

(b) that amount shall be deemed to be tax payable under an assessment and section 103 and the other provisions of Part VII shall apply accordingly.

(5) Where in consequence of any adjustment made under this section an assessment is made, a right to repayment is refused or a return of a repayment of tax is required, particulars of the adjustment shall be given with the notice of assessment, with the notice refusing the repayment or with the notice requiring the return of a repayment, as the case may be.

(6) Transactions —

(a) between persons one of whom has control over the other;

(b) between individuals who are relative of each other; or

(c) between persons both of whom are controlled by some other person,

shall be deemed to be transaction of the kind to which subsection (1) applies if in the opinion of the Director-General those transaction have not been made on terms which might fairly be expected to have made by independent persons engaged in the same or similar activities dealing with one another at arm's-length.

(7) Notwithstanding any other provision of this section, where a transaction to which the section relates consists of a settlement on a relative or on a relative and other persons, nothing in this section and no powers exercised thereunder shall affect the interests of the relative under the settlement.

(8) In this section —

'relative' means a parent, a child (including a step-child and a child adopted in accordance with any law), a brother, a sister, an uncle,

> an aunt, a nephew, a niece, a cousin, an ancestor or a lineal descendent;
>
> 'transaction' means any trust, grant, covenant, agreement, arrangement or other disposition or transaction made or entered into orally or in writing (whether before or after the commencement of this Act), and includes a transaction entered into by two or more persons with another person or persons.

In general, section 140 applies where the transactions have the direct or indirect effect of:

(a) altering the incidence of taxation;

(b) relieving any person from liability to pay tax or make a return under the Income Tax Act;

(c) defeating, avoiding or evading any duty or liability imposed on any person under the Act, or

(d) preventing the operation of the Income Tax Act in any way.

Section 140 of the Malaysian Act has its origins in section 260 of the Australian Income Tax Assessment Act 1936 (Cth.).[15] The only case so far decided in Malaysia under section 140 is *Lahad Datu Timber Sdn. Bhd.* v. *Director-General of Inland Revenue*[16] and even here section 140 was only used as an alternative argument. As a result the Malaysian courts have had no opportunity to consider in detail the scope and limits of the said provision. The experience of courts in Australia and New Zealand, on the other hand, is rich in comparison because since 1924 the courts there have had opportunities to decide issues raised under sections 260 and 108 of the Australian Act and the then New Zealand Land and Income Tax Act 1954 (as amended in 1968)[17] respectively. Consequently, the scope of section

[15] Hereinafter referred to as 'the Australian Act'. For the origins of section 260 of the Australian Act, see W. Wilson, Coopers and Lybrand, 'Section 260 — A Current Assessment Based on Case Law and Recent Amendments to the New Zealand Tax Act' (December 1975 — January 1976) 10 *Taxation in Australia* 370 at pp. 372-373 and I.C.F. Spry, *Arrangements for the Avoidance of Taxation* (2nd ed. 1978).

[16] Originating Motion No. 7 of 1974. For a report of the case see [1977] 6 *Malaysian Tax Journal* 50. Although the case went on appeal to the Federal Court, the appeal did not proceed by way of s. 140.

[17] Hereinafter referred to as 'the then New Zealand Act'. S. 108 of the then New Zealand Act read: "Every contract, agreement or arrangement made or entered into whether before or after the commencement of this Act, shall be absolutely void as against the Commissioner for income tax purposes in so far as, directly or indirectly, it has or purports to have the purpose or effect of in any way altering the incidence of income tax, or, relieving any person from his liability to pay income tax." The change from what was s. 108 of the Land and Income Tax Act 1954 into what is now s. 99 of the Income Tax Act 1976 was effected by s. 9 of the Land and Income Tax Amendment (No. 2) Act 1974. The Land and Income Tax Act 1954 was repealed by s. 436 of the Income Tax Act 1976 and the latter statute applies in respect of the tax on income derived in the income year commencing 1 April 1977. See s. 1(2) of the 1976 Act.

140 of the Malaysian Act, which corresponds to but is not identical with sections 260 and 108 of the Australian and the then New Zealand Acts respectively, will be considered in the light of developments in Australia and New Zealand. Although such an approach is taken it is hoped the Malaysian Courts would not follow Australian and New Zealand decision without a critical examination, in view of important additions in the Malaysian Act, in particular paragraphs (2) and (6) of section 140 of the said Act. The importance of these paragrahs is emphasised at appropriate places in the following pages.

Section 140 of the Malaysian Act has two aspects: the first dealing with the scope of the section and the second dealing with the consequences of the application of the section. The section requires the initial determination of whether there is a transaction having the effect contemplated by the section. If such a transcation is found, the section declares that the Director-General of Inland Revenue[18] may disregard or vary the transaction and make adjustments with a view to counter-acting the whole or any part of any such direct or indirect effect of the transaction.

The authority which is to be regarded as laying down the test for the application of section 260[19] of the Australian Act is *Newton* v. *Federal Commissioner of Taxation*,[20] a decision of the Judicial Committee of the Privy Council which dealt with a scheme of dividend stripping.[21] The Privy Council laid down that section 260 of the Australian Act operates, and it only operates, if the court can predicate by looking at the objective steps used in the transaction, that it was carried out in that particular way to avoid tax. However, if the court cannot so predicate but has to acknowledge that the transaction is capable of explanation by reference to ordinary business or family dealings other than the avoidance of taxation, then section 260 would not apply.[22] The facts there were that three motorcar trading companies after participating in a post-war boom in the motor-car trade had by the end of 1949 accumulated comparatively large profits; the total amount was more than £1,750,000. The shareholders did

[18]Hereinafter referred to as 'the Director-General.'

[19]Section 260 of the Australian Act reads as follows: "Every contract, agreement, or arrangement made or entered into, orally or in writing, whether before or after the commencement of this Act, shall so far as it has or purports to have the purpose or effect of in any way directly or indirectly (a) altering the incidence of any income tax; (b) relieving any person from liability to pay any income tax or make any return; (c) defeating, evading, or avoiding any duty or liability imposed on any person by this Act; or (d) preventing the operation of this Act in any respect, be absolutely void, as against the Commissioner, or in regard to any proceeding under this Act, but without prejudice to such validity as it may have in any other respect or for any other purpose".

[20](1958) 98, C.L.R. 1; [1958] A.C. 450

[21]For comments on dividend stripping operations, see Harry Reicher, 'Dividend Stripping — the end of the Saga?' (September 1977) 12 *Taxation in Australia* 163 at pp. 163-164 and A.P. Molloy, 'Tax Avoidance: New Cases on "Dividend Stripping", 'Choices" and "Disclosure" (February 1977) 11 *Taxation in Australia* 374 at pp. 374-383.

[22](1958) 98 C.L.R. 1 at pp. 8-10; [1958] A.C. 450 at p. 466.

not desire distribution of these profits as dividends because they would attract a very high rate of personal income tax under Australia's progressive tax system. An additional reason for not wishing to distribute the profits was that the companies needed the money they had accumulated as capital. If the profits, however, were left in the companies they would be liable to undistributed profits tax at a very high rate. A sale of the shareholders' interests in the companies would have realised a non-taxable capital gain, but the price would have to be discounted by reference to the liability of each company to undistributed profits tax.

For simplicity the transactions aimed at tax avoidance in relation to one company only will be described. The transactions affecting the other two companies were similar. The company amended its articles of association so as to give special dividend rights to 80,000 ordinary £1 shares, which entitles the holders of those shares to a special dividend of £5 15s. 10d. per share. The total special dividend was nearly £460,000. Following the payment of the divident the shares were to carry only a 5 per cent fixed dividend. The original shareholders, then sold those shares to a company controlled by an accountant, their taxation consultant. This company bore the name of Pactolus Proprietory Limited. The sale price was nearly £460,000, a figure roughly equal to the anticipated dividend. The Pactolus company paid the purchase price of the shares by cheque, and at the same time received from the motor-car company a cheque for the special dividend. The Pactolus company would not have been able to pay for the shares without the special dividend.

The Pactolus company applied to the motor-car company for 400,000 5 per cent preference £1 shares and paid for them by a cheque in favour of the motor company for £400,000. On the following day the Pactolus company sold these new shares to the original shareholders of the motor company for £400,000. The original shareholders paid the purchase price by cheque, out of the £460,000 they had received for the 80,000 ordinary shares.

The scheme required all the cheques in the transaction to be banked simultaneously. The substantial result was that out of the special dividend of £460,000 the original shareholders had reinvested £400,000 as capital in the motor company and they retained £60,000 in cash. The Pactolus company still had 80,000 ordinary shares in the motor company which, because they were now entitled to a fixed dividend of 5 per cent, were worth only £80,000.

The Pactolus company, having received the special dividend, was liable to pay tax on it, but because it was a dealer in shares, it was entitled to deduct losses on its deals from the dividends it received. Having bought the shares in the motor company for £460,000 and sold them for £80,000, it had incurred a loss of £380,000. That loss could be set against the special dividend of £460,000 leaving a net taxable profit of £80,000.

The Privy Council, affirming the decision of the Full Court of the High Court of Australia, upheld the Commissioner's claim that the transactions constituted 'arrrangements' within the meaning of section 260 of the

Australian Act. The Privy Council took the view that the effect of the transactions was, *inter alia* to increase the capital of the motor company in a way which would attract as little tax as possible and to enable the vendor-shareholders to receive an amount of cash without paying tax on it.

The effect of the decision in *Newton's* case will be stated at appropriate places as each aspect of section 140 of the Malaysian Act is discussed in relation to sections 260 and 108 of the Australian and the then New Zealand Acts, respectively.

A. *The Scope of Section 140 of the Income Tax Act, 1967*

Trust, Grant, Covenant, Agreement, Arrangement, and other Dispositions

Section 140 of the Malaysian Act applies to any trust, grant, covenant, agreement, arrangement or other disposition or transaction (including a transaction entered into by two or more with another person or persons) which has the direct or indirect effect specified.

In respect of the word "trust" it is probably used here in a broad sense to refer to any transaction effected by way of a trust which has one or more of the effects described in section 140(1) of the Malaysian Act. The most common examples of schemes effected by way of trusts would be (i) where a person gives or loans money or other property to a trustee or (ii) where he declares himself trustee of money or other property for the benefit of members of the family or (iii) where a unit trust is created. As regard situation (i) and (ii), the question whether the trusts there created would fall within section 140 would generally depend on whether they have one or more of the effects described in that section. In the New Zealand case of *Udy* v. *Commissioner of Inland Revenue*,[23] the taxpayer created a trust in favour of his children. Although he sold his equipment to the family trust, he carried on the harvesting business personally and retained a power to change trustees and made all the business decisions. Wild C.J. held that section 108 of the then New Zealand Act applied, relying mainly on the evidence to find 'that the real power generating the income in question'[24] was the taxpayer and that 'the purpose, the end in view, was relief from tax on a substantial part of the income which the [taxpayer] would otherwise have derived.'[25] The court rejected the taxpayer's contention that the transaction was an ordinary family dealing on the ground that there could be no sensible commercial motive for the scheme. Similarly in *Mangin* v. *Commissioner of Inland Revenue*[26] a trust had been set up by the appellant for the benefit of his wife and children. In each year he

[23] [1972] N.Z.L.R. 714

[24] *Id.*, at p. 717

[25] *Id.*, at p. 718

[26] [1971] N.Z.L.R. 591; [1971] A.C. 739.

leased to the trustees a part of his land which was to be sown with wheat. He was employed by the trustees to sow and reap the crop, and he accounted to them for the proceeds of sale. By using the family trust to carry out this work, the proceeds from the lucrative wheat crop were siphoned off from the taxpayer and split among the family of the taxpayer, who pay lower rates of tax. The majority of the Privy Council held that this arrangement was avoided by section 108 of the then New Zealand Act. The Privy Council was of the view that the whole scheme smacked of 'business unreality' and that the only proper inference to be drawn was that the scheme was devised for the sole purpose of tax avoidance.[27]

However, as was observed by the Privy Council in *Newton's* case[28] if the transactions cannot be predicated as having the purpose of avoiding tax but are reasonably capable of explanation by reference to ordinary business or family dealings then they would not fall within section 260 of the Australian Act and a *fortiori* section 140 of the Malaysian Act. Similarly there is no objection to taxpayers disposing of income-producing property by way of a declaration of trust even though there is a change in the incidence of taxation if such a change is one which the Act contemplated and permitted. Thus in the Australian High Court case of *Deputy Federal Commissioner of Taxation* v. *Purcell*,[29] where it appeared that an owner of pastoral property had declared himself trustee of that property in favour of himself, his wife and his daughter equally, Gavan Duffy and Starke JJ. said:[30]

> "The section, as the Chief Justice says, does not prohibit that disposition of property. Its office is to avoid contracts etc. which place the incidence of the tax or the burden of tax upon some person or body other than the person or body contemplated by the Act. If a person actually disposed of income-producing property to another so as to reduce the burden of taxation, the Act contemplates that the new owner should pay the tax. The incidence of the tax and the burden of the tax falls precisely as the Act intends, namely, upon the new owner."

Situation (iii) may be illustrated by the case of *Phillips* v. *Federal Commissioner of Taxation*,[31] where certain measures were taken by a large accountancy firm, the essence of which was to establish a unit trust for the purposes of (i) minimising possible death duty liabilities and liabilities to tax; (ii) providing the various management and administrative services required by the firm. The Commissioner denied the partnership of deduction for all the amounts paid to the trust on account of the provision of

[27] *Id.*, at pp. 597-598; at p. 750

[28] (1958) 98 C.L.R.1; [1958] A.C. 450

[29] (1921) 29 C.L.R. 464

[30] *Id.*, at p. 473.

[31] (1977) 7 A.T.R. 345.

those services, which action the members of the firm challenged. Waddell J. sitting in the Supreme Court of New South Wales, came to the conclusion that, as a proscribed purpose could not be inferred from the mere establishment of the unit trust, section 260 of the Australian Act did not avoid the contracts for the provision of those services and accordingly section 260 allowed deduction to the partnership for services provided by the trustee. However it should not be taken that the anti-avoidance provisions such as sections 260 and 140 of the Australian and Malaysian Acts respectively will not apply to unit trusts. The facts in each case must be carefully weighed in order to determine whether they are caught by these sections.

The word 'grant' is probably used here in its ordinary sense to mean a transfer or conveyance of real property[32] which has one or more of the effects specified in section 140(1) of the Malaysian Act. Despite its narrow construction, it appears that conveyances or transfers of other kinds of properties which have one or more of the specified effects would also come within section 140 of the said Act in view of the phrase '. . . or other disposition or transaction . . .' immediately following the word 'grant.'

The word 'covenant' may be taken to refer to any promise or agreement between two parties or more which has one or more of the effects specified in section 140(1) of the Malaysian Act. In *De Romero* v. *Read*[33] a husband entered into a covenant wherein he agreed with his wife to pay certain income tax otherwise payable by her. The court held that the covenant was void under a provision equivalent to section 260 of the Australian Act.[34] If the facts were to arise in Malaysia, the covenant in question may be varied or disregarded by the Director-General under section 140 for income tax purposes as it has the effect of altering the incidence of tax. However, section 140 of the said Act does not enable the Director-General to vary or disregard the covenant as between the parties.[35]

The word 'agreement' is somewhat ambiguous. It can be taken to mean an agreement which alters the legal rights or obligations of the parties or it could mean, in a broader sense, an agreement in fact, which may or may not amount to an agreement that binds the parties legally. Judicial authority from Australia on this point appears to be ambiguous or else incline to the view that in section 260 of the Australian Act, the word 'agreement' is used in the first of the two senses which have been referred to. In *Newton* v. *Federal Commissioner of Taxation*,[36] *supra* the Privy Council said that

[32]This is also the view of Mr. Lee Beng Fye, Deputy Director-General of Inland Revenue, Malaysia, interviewed on 3 October 1979.

[33](1932) 48 C.L.R. 649

[34]It should be noted that the phrase 'absolutely void as against the Commissioner' was added to s. 260 of the Australian Act in 1936.

[35]This is also the position under ss. 260 and 108 of the Australian and the then New Zealand Acts respectively. These sections do not avoid the transactions as between the parties.

[36](1958) 98 C.L.R. 1; [1958] A.C. 450

the word 'arrangement' was apt to describe 'something less than a binding contract or agreement.'[37] This statement appeared to suggest that the agreements referred to by section 260 are agreements which have an effect at law.

However, as will be seen below, in view of the wide construction which the word 'arrangement' has come to receive, it can be safely assumed that nothing will fall outside the operation of sections 260, 108 and 140 of the Australian, the then New Zealand and the Malaysian Acts respectively merely because the word 'agreement' is construed narrowly.

As regards the word 'arrangement' Dixon C.J., Williams, Webb, Fullagar and Kitto J.J. in *Bell* v. *Federal Commissioner of Taxation*,[38] a decision of the High Court of Australia, stated in their joint judgment that the series 'contract, agreement or arrangement' is one which, as regards comprehensiveness, is an ascending series and that the word 'arrangement'

> ". . . extends beyond contracts and agreements so as to embrace all kinds of concerted action by which persons may arrange their affairs . . . so as to produce a particular effect."[39]

Accordingly any trust, grant, covenant, or agreement which is directed towards the avoidance of tax would be covered by the word 'arrangement' in view of the fact that it embraces 'all kinds of concerted action.' The observation of the Privy Council in *Newton's* case,[40] as to the ambit of the word 'arrangement' should also be noted. The Privy Council was of the view that the word 'arrangement' refers to 'something less than a binding contract or agreement', 'something in the nature of an understanding', 'a plan arranged between parties which may not be enforceable at law.'[41] Although the ambit of 'arrangement' as defined by the Privy Council in *Newton's* case is not as embracing as that given in *Bell's* case, there appears to be no inconsistency between the two and any trust, grant, covenant, or agreement would equally be covered by the word 'arrangement' in so far that they are entered into in pursuance of an 'understanding' or 'plan' to avoid tax. Thus it is not surprising that the Privy Council in *Newton's* case used the term 'arrangement' to cover the three words actually used in section 260 of the Australian Act. In the light of the observations made by the court in *Bell's* case and *Newton's* case with regard to the word 'arrangement' it is submitted that the word 'arrangement' in section 140 of the Malaysian Act is wide enough to cover any trust, grant, covenant or agreement directed to the avoidance of tax and accordingly

[37] *Id.*, at p. 465

[38] (1953) 87 C.L.R. 548.

[39] *Id.*, at p. 573

[40] (1958) 98 C.L.R. 1; [1958] A.C. 450

[41] *Id.*, at pp. 7-8; at p. 465.

the phrase 'trust, grant, covenant or agreement . . .'' may be considered otiose.

In this connexion, it may be appropriate to point out that the observation of the Privy Council in *Newton's* case that the word 'arrangement', was apt to describe something in the nature of an understanding between two or more persons, is apparently based on a view that there cannot be an 'arrangement' without the participation of two or more persons. However it is possible to think of circumstances where one person only is involved in a series of transactions directed to the avoidance of tax for example when a trustee declares complex trusts in favour of unborn children. In the absence of any decision on this point, it would not be safe to conclude that cases of this nature would not come within the word 'arrangement' in sections 260, 108[42] and 140 of the Australian, the then New Zealand and the Malaysian Acts respectively.

The phrase '. . . or other disposition or transaction . . .' in section 140(8) of the Malaysian Act would cover transactions which do not come within the word '. . . any trust, grant, covenant, agreement, arrangement . . .' and which have one or more of the effects specified in section 140(1) of the said Act. To hold that the *ejusdem generis* rule is to be applied in the interpretation of the phrase '. . . or other disposition or transaction . . .' would be to unduly restrict the scope and effectiveness of section 140 of the Malaysian Act and render the phrase meaningless. However, this point is very largely of an academic nature in view of the wide construction given to the word 'arrangement' as noted earlier.

A further point to be noted is whether an 'artificial' or 'fictitious' transaction can fall within section 140(1) of the Malaysian Act. The answer to this question would seem to be in the affirmative. This is simply because 'artificial' and fictitious' transactions are clearly transactions which alter the incidence of tax. The word 'artificial', which is of a wider import, means something which is not natural or normal, something out of the ordinary. A 'fictitious' transaction, on the other hand, is one in which those who are ostensibly the parties to it never intended it should be carried out — that is to say it is a sham[43] transaction. Accordingly, any transaction which *inter alia* alters the incidence of tax will be caught by section 140 of the said Act including 'artificial' or 'fictitious' transactions since such transactions necessarily alter the incidence of tax.

It would appear from the Australian decided cases that sham[44] transactions would fail in any event and without the aid of section 260 of the

[42]Now s. 99 of the New Zealand Income Tax Act 1976.

[43]In *Snook* v. *London and West Riding Investments* [1967] 2 Q.B. 786, the word 'sham' was defined by Diplock L.J. at p. 802 as follows: ''. . . acts done or documents executed by the parties to the 'sham' which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create.''

[44]Here the word 'sham' is taken to mean a transaction without legal effect and where no enactment is needed to nullify them.

Australian Act which section corresponds to section 140 of the Malaysian Act.[45] In *Jaques* v. *Federal Commissioner of Taxation*,[46] Issacs J. said:

> "That the transaction is a reality is not reason for the non-application of the section. On the contrary, if the transactions were not real and effective apart from the section, that section would be unnecessary. A sham transaction is inherently worthless and needs no enactment to nullify."[47]

In the words of Fullagar J. in *Newton's* case[48] :

> "The section is not aimed at fraudulent conduct, or at pretended, as distinct from real transactions. Such cases need no special statutory provision. It is aimed at transactions which are, in themselves, real and lawful, but which the legislature desires to nullify so far, and only so far, as they may operate to avoid tax."

and again in *Hancock* v. *Federal Commissioner of Taxation*[49] Windeyer J. stated:

> "In a case under section 260 one starts with the position that the arrangement that is avoided as against the Commissioner is valid as between the parties — that is to say that it is a legal reality and not a sham; because, if it were a sham, it would fall in any event, and without the aid of section 260."

The Malaysian Courts are likely to adopt the same approach in view of the close similarity in wordings of sections 140(1) and 260 of the Malaysian and Australian Acts respectively and the fact that sham transactions are, by their very nature, without legal effect and hence cannot effect any alteration in the incidence of tax.

However, it is the writer's opinion that although section 260 of the Australian Act is not concerned with sham transactions which have no legal effect anyway and which the Commissioner can ignore without having to rely on section 260, this section is nevertheless aimed at a transaction which is a sham in another sense, namely a transaction which is real in the sense that the parties intend it to take effect but which is carried out by what, in the light of business or family dealing, would be characterised as unreal means. Thus the steps in *Newton's* case, involving the exchange of cheques and the intervention of the trading company (that is, Pactolus Com-

[45] This is also the position under s. 108 of the then New Zealand Act, the equivalent of s. 260 of the Australian Act. The New Zealand Court of Appeal in *Elmiger* v. *Commissioner of Inland Revenue* [1967] N.Z.L.R. 161 held that the section was intended to apply to transactions which are genuine in the sense that real liabilities are intended to be undertaken and discharged and rejected the argument that the section applies only to sham transactions.

[46] (1924) 34 C.L.R. 328

[47] *Id.*, at p. 358

[48] (1957) 96 C.L.R. 577 at pp. 646-647

[49] (1961) 108 C.L.R. 258 at p. 301

pany) — an intervention which was explicable only in terms of tax avoidance and not in terms of an increase of capital — were such as to make the transaction appear unreal.

Transactions having the 'direct or indirect effect'

It has been seen that section 140 of the Malaysian Act applies to any trust, grant, covenant, agreement, arrangement or other disposition or transaction that has one or more of the effects that are there set out. It is now proposed to discuss the construction that has been given by the courts to the clause 'so far as it has or purports to have the purpose or effect of . . .' in section 260 of the Australian Act to determine to what extent such construction may help in defining the scope of the phrase 'direct or indirect effect' in section 140(1) of the Malaysian Act.

Section 260 of the Australian Act applies not only to contracts, agreements or arrangements that have one or more of the purposes or effects described therein, but also to contracts, agreements or arrangements which purport to have any of these purposes or effects. However, notwithstanding the absence of the phrase '. . . or purports to have . . .' in section 140(1) of the Malaysian Act, it is the writer's view that its absence does not make the scope of section 140 of the Malaysian Act any narrower when compared to that of section 260 of the Australian Act. It will be seen from the dicta of some judges that the words 'or purports to have' have been treated as having little, if any, importance. Fullagar J. in *Federal Commissioner of Taxation* v. *Newton*[50] was of the view that:

> "The primary criterion — though the section adds *ex abundanti cautela* a reference to 'purported effect' — is the purpose which the particular transaction in question was designed to effect."[51]

Thus it would appear that the phrase 'or purports to have' has been inserted out of an abundance of caution and not with any particular purpose in mind. In the same case Kitto J., after discussing what contracts, agreements or arrangements the words 'the purpose or effect' were directed to, added,[52]

> "the expression 'has or purports to have' seems to carry out the same idea."

Accordingly, the purported purpose or effect of an arrangement in section 260 of the Australian Act may be taken to be the same as its actual purpose or effect.

[50](1957) 96 C.L.R. 577

[51]*Id.*, at p. 647

[52]*Id.*, at p. 598

Regarding the word 'purpose' in section 260 of the Australian Act, it is submitted that, despite its presence, there is no real difference in meaning between the words 'purpose' and 'effect'. In *Federal Commissioner of Taxation* v. *Newton*[53] Williams J. made certain observations as to the meaning of the words 'purpose or effect.' His Lordship said:

> "These words are in the alternative but they do not appear to me to have any real difference in meaning. The purpose of a contract, agreement or arrangement must be what it is intended to effect and that intention must be ascertained from its terms. These terms may be oral or written or may have to be inferred from the circumstances but, when they have been ascertained, their purpose must be what they effect."

On this view, the purpose of an arrangement is the same as its effect. It will also be seen that the construction given to the words 'purpose' and 'effect' by the Privy Council in *Newton's* case,[54] does not differ much from that noted above. Their Lordships said:[55]

> "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 denotes concerted action to an end — the end of avoiding tax."

Accordingly, the presence of the word 'purpose' in section 260 of the Australian Act does not make its scope any wider than section 140 of the Malaysian Act. This is simply because, as observed by Williams J. in *Newton's* case,[56] the purpose of a transaction must be what it is intended to effect and hence, is the same as its effect.

As noted above section 260 of the Australian Act, to which section 140(1) of the Malaysian Act corresponds with, applies to arrangements which have as their end in view, or as their end achieved, the avoidance of tax. It is the arrangement's purposes or effects which are crucial and the expressed motives of the parties explaining their reasons are irrelevant. As their Lordships said in the Privy Council in *Newton's* case:[57]

> ". . . the opening words of the section . . . show that the section is not concerned with the motives of individuals. It is not concerned with their desire to avoid tax, but only the means which they employ to do it . . . In applying the section

[53] *Id.*, at p. 630. A somewhat different analysis is found in the judgment of Kitto J. in the same case at p. 598. But his decision was reversed by the Full Court on appeal and it is doubtful if any weight may be given to the dicta there delivered by him.

[54] (1958) 98 C.L.R. 1; [1958] A.C. 450. It should be noted that their Lordships approved the observations of Williams J. as to the meaning of the words 'purpose or effect.'

[55] *Id.*, at p. 8; at p. 465

[56] (1957) 96 C.L.R. 577 at p. 630

[57] (1958) 98 C.L.R. 1 at p. 8; [1958] A.C. 450 at p. 465

> you must, by the very words of it, look at the arrangement itself and see which is its effect — which it does — irrespective of the motives of the persons who made it . . ."

Thus, the evaluation is to be made by an objective consideration of the arrangement itself and section 260 of the Australian Act, to which sections 140 and 108 of the Malaysian and the then New Zealand Acts respectively corresponds, is not concerned with the desires of individuals to avoid tax but only with their means of doing it. Such an interpretation has the advantage of avoiding the contentious determination of whether the arrangement had been prompted by reasons of tax avoidance or not.

That this is also the position under section 108 of the then New Zealand Act can be seen in the Privy Council case of *Ashton* v. *Commissioner of Inland Revenue*[58] where their Lordships in endorsing the observation of the Privy Council in *Newton's* case[59] held that the problem of ascertaining an arrangement's purpose or effect must be approached on the basis that:

> "If an arrangement has a particular purpose, then that will be its intended effect. If it has a particular effect, then that will be its purpose and oral evidence to show that it has a different purpose or different effect to that which is shown by the arrangement itself is irrelevant to the determination of the question whether the arrangement has or purports to have the purpose or effect of in any way altering the incidence of income tax or relieving any person from his liability to pay income tax."[60]

It followed, as their Lordships went on to emphasise, that the material purpose or effect could be determined only by reference to the arrangement itself and not by reference to the parties' subsequent conduct.

The authorities appear to emphasise that an 'incidental' purpose or effect of avoiding tax of an arrangement can be ruled out of consideration on the issue of the applicability of sections 260 and 108[61] of the Australian and the then New Zealand Acts respectively. To be caught by these sections the purpose or effect of avoiding tax must at least be a substantial purpose or effect of the arrangement. Thus in *Purdie* v. *Commissioner of Inland Revenue*[62] Wilson J. said:

> "To bring the arrangement within the section in those cases [where it can be predicated that the arrangement was implemented in its particular way so as

[58] [1975] 2 N.Z.L.R. 717; [1975] 1 W.L.R. 1615

[59] (1958) 98 C.L.R. 1; [1958] A.C. 450

[60] [1975] 2 N.Z.L.R. 717 at p. 722; [1975] 1 W.L.R. 1615 at p. 1621.

[61] The present s. 99(1)(b) of the New Zealand Income Tax Act 1976 makes provision to the same effect.

[62] (1965) 9 A.I.T.R. 603 at p. 609; See also *Hancock* v. *Federal Commissioner of Taxation* (1962-63) 108 C.L.R. 258 at p. 271; *Peate* v. *Federal Commissioner of Taxation* (1964-65) 111 C.L.R. 466 at p. 476.

> to alter the incidence of income tax] the element of altering the incidence of taxation or relieving some person of his liability therefore must be a substantial purpose or effect and not merely an incidental consequence of the arrangement."

Furthermore, the purpose must be also an actuating or 'essential' purpose as Gibbs J., in an extensive review of the authorities, held in *Hollycock* v. *Federal Commissioner of Taxation*.[63]

A finding that the purpose or effect of the arrangement is 'incidental' is most likely where the taxpayer can satisfy the court that the impugned arrangement would have been embarked upon irrespective of its income tax advantages. This the taxpayer was able to do in *Loader* v. *Commissioner of Inland Revenue*.[64] The facts there were that the taxpayer had for several years carried on in his own behalf a successful earthmoving contractor's business. But then, determined to reorganise his affairs, the taxpayer first established a family trust and incorporated a company (the shareholding in which was held by two family trusts, each of which benefited the family of the taxpayer and that of his financial adviser). The taxpayer next sold most of his plant and equipment to the family trust and the rest to the company. In each case, the purchase price was interest-free and repayable on demand. The family trust then bailed its assets to the company, which then employed the taxpayer to utilise them in the same enterprise that he had previously conducted. The court found that the purpose of the arrangement had been 'the twin advantages of incorporation and of providing some capital and income security for members of the objector's family by permanently transferring assets for their benefit.'[65]

The learned Judge did find, in addition, not only that tax saving was one of the motives but also that:

> "From the documents it may be inferred that estate duty and tax savings may well each have been included in the purposes of the arrangement . . ."[66]

However, the crucial factor was that, notwithstanding the finding that tax avoidance had been one of the purpose of the arrangement, it was an incidental or subsidiary purpose and the taxpayer would have adopted this 'wholesale reorganisation' of his affairs regardless of the taxation advantages obtained. Accordingly section 108 of the then New Zealand Act did not apply.

As to whether the purpose or effect must be the sole purpose or effect of the transaction, the Privy Council in *Newton's* case[67] was of the view

[63] [1971] 2 A.T.R. 601 at p. 605.

[64] [1974] 2 N.Z.L.R. 472

[65] *Id.*, at p. 477.

[66] *Ibid.*

[67] (1958) 98 C.L.R. 1; [1958] A.C. 450

that although in the circumstances of the case before them, the avoidance of tax was not the sole purpose or effect of the arrangement, section 260 of the Australian Act can still apply if one of the purposes or effects was to avoid liability for tax because of the presence of the phrase 'so far as it has.' This phrase, in their Lordships' view, import that the avoidance of tax need not be the sole purpose or effect. This view of their Lordships corresponds with that made in the same case by Williams and Kitto J.J. in the High Court[68] and such view has also been expressed on various subsequent occasions.[69]

However, in the New Zealand case of *Mangin* v. *Commissioner of Inland Revenue*[70] the majority of the Privy Council took the view that the phrase 'without necessarily being labelled as a means to avoid tax' contained in the Privy Council decision in *Newton's* case[71] refer to:

> ". . . a scheme . . . devised for the sole purpose, or at least the principal purpose of bringing it about that this taxpayer should escape liability on tax for a substantial part of the income which, without it, he would have derived."[72]

In the subsequent case of *Ashton* v. *Commissioner of Inland Revenue*[73] the Privy Council quoted the statement of Lord Denning in *Newton's* case[74] that the inclusion of the words 'so far as it has' showed that the avoidance need not be the sole purpose. However in a later Privy Council case, *Europa Oil (N.Z.) Ltd. (No. 2)* v. *Commissioner of Inland Revenue*,[75] it was stated that:

> ". . . the section in any case does not strike down transactions which do not have as their main purpose or one of their main purposes tax avoidance. It does not strike down ordinary business or commercial transactions which incidentally result in some saving of tax."[76]

This statement appears to resurrect the 'principal purpose' test used in *Mangin's* case[77] or at least a close relative of it.

[68](1957) 96 C.L.R. 577 at pp. 597, 634-635

[69]*Hancock* v. *Federal Commissioner of Taxation* (1961) 108 C.L.R. 258; *Millard* v. *Federal Commissioner of Taxation* (1962) 108 C.L.R. 336.

[70][1971] N.Z.L.R. 591; [1971] A.C. 739

[71](1958) 98 C.L.R. 1; [1958] A.C. 450

[72][1971] N.Z.L.R. 591 at p. 598; [1971] A.C. 739 at p. 751

[73][1975] 2 N.Z.L.R. 717; [1975] 1 W.L.R. 1615

[74](1958) 98 C.L.R. 1; [1958] A.C. 450

[75][1976] 1 N.Z.L.R. 546; [1976] 1 W.L.R. 464

[76]*Id.*, p. 556; at p. 475.

[77][1971] 1 N.Z.L.R. 591; A.C. 739. However, the present s. 99 of the New Zealand Income Tax

The only case on section 140 of the Malaysian Act, *Lahad Datu Timber Sdn. Bhd.* v. *Director-General of Inland Revenue*,[78] appears to have adopted the observations made by the majority of the Privy Council in *Mangin's* case. One of the issues that came before the High Court for a decision was whether section 140 of the said Act applied to the transaction entered into by the taxpayer. The taxpayer signed two arrangements; one for timber extraction and the other for the sale of timber and the execution of certain works. As both the agreements were executed on the same day by the same parties, the Revenue maintained that this was for the purpose of avoiding income tax and therefore section 140 is applicable. Yusuf J. in holding that section 140 of the Malaysian Act was not applicable to the case before him said:

> "In my opinion, 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. In the words of Lord Denning in *Newton* v. *F.C. of T.* (1958) A.C. 450; (1958) 2 All E.R. P.C. 759 at p. 764:
>
> > 'In order to bring the arrangement within the section, you must be able to predicate — by looking at the overt acts by which it was implemented — that it was implemented in that particular way so as to avoid tax. If you cannot so predicate but have to acknowledge that the transactions are capable of explanation by reference to ordinary business or family dealing, without necessarily being labelled as a means to avoid tax, then the arrangement does not come within the section.'
>
> Newton's case was a decision of the Privy Council resting on section 260 of the Australian (Commonwealth) Income Tax Assessment Act 1936 — 1960 which is *in pari materia* with our section 140 of Act 53.
>
> In explaining this passage Lord Donovan in delivering the majority judgment of the Judicial Committee in *Mangin* v. *C. of I.R.* (1971) 2 W.L.R. 39 at p. 47 said:
>
> > '. . . this passage, properly interpreted, does not mean that every transaction having as one of its ingredients some tax saving feature thereby becomes caught by a section such as section 108. If a *bona fide* business transaction can be carried through in two ways, one involving less liability to tax than the other, their Lordships do not think section 108 can properly be invoked to declare the transaction wholly or partly void merely because the way involving less tax is chosen . . . The clue to Lord Denning's meaning lies in the words without necessarily being labelled as a means to avoid tax. Neither of the examples above given could justly be so labelled. Their Lordships think

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Act 1976 will apply if tax avoidance is only one of the purposes or effects of an arrangement provided that it is more than being a merely incidental purpose or effect.

[78] Originating Motion No. 7 of 1974. For a report of the case see [1977] 6 *Malaysian Tax Journal* 50.

> that what this phrase refers to is, to adopt the language of Turner J. in the present case,
>
> 'a scheme . . . devised for the sole purpose, or at least the principal purpose, of bringing it about that this taxpayer should escape liability on tax for a substantial part of the income which, without it, he would have derived.'
>
> *Mangin's* case is a decision of the Privy Council on the application of section 108 of the New Zealand Land and Income Tax Assessment Act 1936 — 1960, section 260 *ibid.*
>
> In applying these principles to the present case and by looking at the two agreements, in my opinion, it cannot be said that the transaction was done to avoid tax . . . In my view, the principal purpose of the scheme or transaction designed by the appellant company was to facilitate the development of the land and the execution of works of building houses, school and other facilities relating to such development."[79]

Nevertheless, it is respectfully submitted that notwithstanding the decision of Yusuf J. in *Lahad Datu Timber Sendirian Berhad's* case and the absence of the phrase 'so far as it has' from section 140(1) of the Malaysian Act, the Malaysian courts should adopt and prefer the observations of *Newton's* case[80] to that of *Mangin's* case[81] namely that for section 140 of the Malaysian Act to apply, tax avoidance need not be the sole purpose or effect of the arrangement so long as one of the purposes or effects is to avoid liability for tax. The reason for enacting section 140 of the said Act becomes very clear when it is borne in mind that the common law saw no wrong in 'legitimate tax avoidance devices.' The purpose of section 140, obviously, is to overcome such a judicial attitude. Accordingly, to hold that tax avoidance must be the sole purpose or effect of the arrangement would be to frustrate this objective of section 140 of the Malaysian Act.

Altering the Incidence of Income Tax which is Payable or suffered by or which would otherwise have been payable or suffered by Any Person.

The words 'altering the incidence of income tax' contained in sections 260(a), 108(a) and 140(1)(a) of the Australian, the then New Zealand and the Malaysian Acts respectively appear to refer to (i) transactions which transfer the incidence of tax from one party to another and (ii) transactions which reduce the amount of tax payable by a taxpayer without any corresponding increase in the amount of tax paid by any other person.[82]

[79] *Id.*, at p. 63.

[80] (1958) 98 C.L.R. 1; [1958] A.C. 450

[81] [1971] N.Z.L.R. 591; [1971] A.C. 739

[82] J.C.F. Spry, *Op. cit.*, at p. 41

Although New Zealand cases such as *Elmiger* v. *Commissioner of Inland Revenue*[83] and *Mangin* v. *Commissioner of Inland Revenue*[84] have held that section 108 of the then New Zealand Act which contained the words 'altering the incidence of income tax' has both fiscal and *inter partes* effect, it is submitted that sections 260, 108 and 140(1)(a) of the Australian, the then New Zealand and the Malaysian Acts respectively do not avoid the aforesaid transactions as between the parties but only as against the Commissioner or Director-General of Inland Revenue as the case may be. This is because of the phrase '. . . absolutely void as against the Commissioner for income tax purposes . . .' in the New Zealand section, the phrase '. . . absolutely void as against the Commissioner . . . but without prejudice to such validity as it may have in any other respect or for any other purpose . . .' in the Australian section and the phrase '. . . without prejudice to such validity as it may have in any other respect or for any other purpose . . .' in the Malaysian section. It should be noted that section 108 of the then New Zealand Act considered in the two cases aforesaid was in its unamended form and did not contain the phrase '. . . as against the Commissioner for income tax purposes' which was inserted only in 1968.[85]

The words 'altering the incidence of income tax' contained in sections 260(a) and 108(a) of the Australian and the then New Zealand Acts respectively must be taken to cover transactions to avoid a future or imminent liability to tax that has not yet accrued. In *Mangin's* case[86] the majority of the Privy Council stated quite generally when considering section 108 of the then New Zealand Act:

> "The second contention of the appellant is that section 108 refers only to accrued liabilities to tax and not to liabilities which may be expected in future . . . There is, however, another possible meaning. The taxpayer, considering the provisions of fiscal legislation, may discern that by entering into some arrangement he can so distribute the legal incidence of tax upon his income that he himself will pay less. In other words, the economic incidence is altered. In their Lordships' view this is what is contemplated by section 108."[87]

It is submitted that this is also the position under section 140(1)(a) of the Malaysian Act. By employing the words '. . . or which would otherwise have been payable or suffered by any person', section 140(1)(a) would cover transactions which are undertaken to prevent the occurrence of facts or matters which will give rise to that expected liability.

[83] [1967] N.Z.L.R. 161

[84] [1971] N.Z.L.R. 591; [1971] A.C. 739

[85] By s. 16(1) of the Land and Income Tax Amendment Act (No. 2) 1968.

[86] [1971] N.Z.L.R. 591; [1971] A.C. 739

[87] *Id.*, at p. 596; at p. 784. In New Zealand, the present s. 99 of the Income Tax Act 1976 extends to transactions which avoid a potential or prospective liability in respect of future income.

It has been suggested[88] that the words 'altering the incidence of any income tax' in section 260(a) of the Australian Act must be taken to refer only to alterations that are not approved or intended to be opened by other provisions in the Act in view of the 'choice principle' propounded in cases such as *W.P. Keighery Pty. Ltd.* v. *Federal Commissioner of Taxation*[89] and *Federal Commissioner of Taxation* v. *Casuarina Pty. Ltd.*[90] namely that where particular provisions in the Act itself provide the taxpayer with a choice of alternative courses of action, his adoption of the one which involves him in less tax is not an action which will of itself attract the operation of the general anti-tax avoidance sections. As will be seen,[91] the 'choice principle' has been further expanded in a series of High Court decisions in *Mullens* v. *Federal Commissioner of Taxation*,[92] *Slutzkin* v. *Federal Commissioner of Taxation*[93] and *Cridland* v. *Federal Commissioner of Taxation*.[94] It remains to be seen how far the Malaysian courts will accept the 'choice principle' as developed by the Australian courts. It is however, unlikely that the Malaysian courts will apply the 'choice principle' to the extent that it severely restricts the scope of operation of section 140 of the Malaysian Act as a general anti-tax avoidance provision. To do so would go against the intent and spirit of section 140, which may be seen as a legislative attempt to prohibit transaction which employ artificial means to circumvent specific provisions controlling the liability to tax or exploit provisions granting concessions to that liability.[95]

Relieving Any Person from Any Liability which has Arisen or which would otherwise have Arisen to Pay Tax or to Make a Return

In *Mangin's* case,[96] the Privy Council considered the extent of the application of a provision in section 108 of the then New Zealand Act which was similar to paragraph (b) of section 260 of the Australian Act and which corresponded with section 140(1)(b) of the Malaysian Act. It should be

[88] I.C.F. Spry, at p. 42.

[89] (1957) 100 C.L.R. 66

[90] (1971) 127 C.L.R. 62

[91] See next issue of JMCL

[92] (1976) 6 A.T.R. 504

[93] (1977) 7 A.T.R. 166

[94] (1977) 8 A.T.R. 169

[95] See Y.F.R. Grbich, 'Section 260 Re-Examined; Posing Critical Questions About Tax Avoidance' (1976) 1 *University of New South Wales Law Journal* 211 at pp. 213-224 as to the objectives of s. 260 of the Australian Income Tax Assessment Act 1936 (Cth.). His views are equally applicable in respect of s. 140 of the Income Tax Act 1967, the Malaysian equivalent to s. 260 of the Australian Income Tax Assessment Act 1936 (Cth.).

[96] [1971] N.Z.L.R. 591; [1971] A.C. 739

noted that section 108 of the then New Zealand Act did not contain the provisions of paragraphs (c) and (d) of sections 260 and 140(1) of the Australian and Malaysian Acts respectively. It was argued in *Mangin's* case that the words 'relieving any person from his liability to pay income tax' were narrower than the words 'defeating, evading or avoiding any duty or liability imposed on any person by this Act or preventing the operation of this Act in any respect' which had appeared in earlier comparable provisions. The majority of the Privy Council rejected this view and said :

> "In the ordinary use of language one 'secures relief from tax' if one 'defeats' it or 'evades' it, or 'avoids' it."[97]

Their Lordships were of the view that the true reason for the omission of the material words was '. . . probably that they were regarded as tautologous . . .''[98] and agreed with the observations made by the court in *Marx* v. *Commissioner of Inland Revenue*[99] that the expression 'relieving any person from liability to pay income tax' should be given a broad effect.

However, it is submitted that in view of the presence of paragraphs (c) and (d) in sections 260 and 140(1) of the Australian and Malaysian Acts respectively, the scope of operation of paragraph (b) of sections 260 and 140(1) of the Australian and Malaysian Acts respectively, as ascribed by *Mangin's* case to its New Zealand counterpart, should be read so as not to curtail or render otiose the operation of paragraphs (c) and (d) of section 260 and 140(1) of the Australian and Malaysian Acts respectively. The observations made by the majority of the Privy Council in *Mangin's* case were made in a different context, namely in the absence of paragraphs (c) and (d) in section 108 of the then New Zealand Act. Furthermore, as Lord Wilberforce observed[1] in *Mangin's* case, paragraphs (c) and (d) are wider than paragraphs (a) and (b) of section 260 of the Australian Act which appears to deal with specific limited cases.

The word 'liability' referred to in the expression 'relieving any person from any liability which has arisen' was held by the majority of the Privy Council in *Mangin's* case to refer to an expected or future liability. That this is also the position under section 140(1)(b) of the Malaysian Act may be seen from the phrase '. . . or which would otherwise have arisen . . .' which could be said to be directed at the avoidance of future liabilities which would have arisen in due course. If the liability had already accrued,

[97] *Id.*, at p. 596; at p. 749

[98] *Ibid.*

[99] [1970] N.Z.L.R. 182

[1] [1971] N.Z.L.R. 591 at p. 601; [1971] A.C. 739 at p. 752.

arrangement having the effect of relieving the taxpayer from it would be useless since income once derived cannot be underived.[2]

The expression in section 260(b) of the Australian Act must not be taken to refer to all transactions which have the effect of relieving any person from liability to pay income tax in view of the 'choice principle' developed by the Australian courts.[3] However, it is left to be seen how far the Malaysian courts will accept this 'choice principle' developed by the Australian courts. As pointed out earlier, it is unlikely that the Malaysian courts will apply the 'choice principle' to the extent that it will unduly restrict the scope of operation of section 140 of the Malaysian Act as a provision designed to catch transactions which are directed at tax avoidance. A balance will have to be struck between the application of the 'choice principle' and the objective of section 140 of the Malaysian Act which is to combat tax avoidance.

Evading or Avoiding Any Duty or Liability which is Imposed or would otherwise have been Imposed on any Person by this Act

The expression 'evading or avoiding any duty or liability' has been taken to cover circumstances in which the liability or duty in question is yet to accrue and where the material transaction is directed to prevent the future occurrence of facts or matters which will give rise to that duty or liability. In *Federal Commissioner of Taxation* v. *Newton*[4] Taylor J. said :

> "Since it is clear that the real work of the section is intended to be done in cases where the disputed item of income has not in fact or law been derived by a taxpayer, the section must be taken to contemplate that even before income has been derived, a taxpayer may, by a legally effective contract, agreement or arrangement, avoid a liability to income tax on future income . . . [I]n an attempt to give some intelligible meaning to the section the view has been taken that there may be, on the part of a taxpayer, an avoidance of liability to tax, within the meaning of the section, in respect of income before that income has been derived."

On appeal to the Privy Council, counsel for the taxpayers in *Newton's* case[5] unsuccessfully submitted that, in section 260(c), the words 'liability imposed on any person' meant a liability which had already accrued; and that 'avoid' meant displace. With regard to that submission Lord Denning said[6] :

[2] *Newton* v. *Federal Commissioner of Taxation* (1958) C.L.R. 1 at p. 7; [1958] A.C. 450 at p. 464

[3] I.C.F. Spry, *op. cit.*, at p. 44

[4] (1957) 96 C.L.R. 577 at p. 665

[5] (1958) 98 C.L.R. 1; [1958] A.C. 450

[6] *Id.*, at p. 7; at p. 465. Sir Garfield Barwick, counsel for the taxpayers in *Newtons'* case, appear to have emphasised the word 'imposed' rather than the word 'avoid'.

"Their Lordship cannot accept this submission. They are clearly of the opinion that the word 'avoid' is used in its ordinary sense — in the sense in which a person is said to avoid something which is about to happen to him. He takes steps to get out of the way of it. It is this meaning of 'avoid' which gives the clue to the meaning of 'liability imposed.' To 'avoid a liability imposed' on you means to take steps to get out of the reach of a liability which is about to fall on you. If the submission of Sir Garfield Barwick were accepted, it would deprive the words of any effect; for no one can displace a liability to tax which has already accrued due, or in respect of income which has already been derived. Their Lordships notice that, although this point was not raised in the High Court, Taylor J., did consider it, and they find themselves in agreement with what he said upon it."

To argue that the phrase 'avoiding any duty or liability' meant a liability which had already accrued would be inconsistent with cases such as *Bell* v. *Federal Commissioner of Taxation*[7] where it was stated that :

"Section 260(c) postulates a duty or a liability imposed on a person by the Act, but this refers, not to a liability to pay a particular amount of tax (which would be a liability imposed by a taxing Act) . . . but to a liability to pay tax in respect of his taxable income ascertained by including in his assessable income his proportion of the Papuan Company's profits if and when he should participate in a distribution of them."[8]

Accordingly the arrangements in *Bell*'s case which were directed towards the avoidance of future liabilities were held to be void.

Section 140(1)(c) of the Malaysian Act appears to have incorporated the above observations made in *Newton's* case and *Bell's* case in the phrase '. . . or would otherwise have been imposed on any person by this Act . . .' This phrase could be said to cover situations where transactions are directed to prevent the future occurrence of facts or matters which will give rise to that expected liability.

The width of this concept of 'avoiding' a liability to tax must be restricted for otherwise it would refer to even transactions which are not intended to avoid liability to tax but which inevitably have such an effect for example a *bona fide* declaration of trust or disposition of income — producing property. Accordingly sections 260 and 140 of the Australian and Malaysian Acts respectively should not be taken to apply to every transaction, for if the transaction, in accordance with the test that was laid down by the Privy Council in *Newton's* case,[9] is capable of explanation by

[7](1953) 87 C.L.R. 548

[8]*Id.*, at pp. 573-574

[9](1958) 98 C.L.R. 1 at pp. 8-10; [1958] A.C. 450 at p. 466

reference to considerations such as ordinary business or family dealings other than the avoidance of taxation, then sections 260 and 140 of the Australian and Malaysian Acts respectively would not apply.[10]

As is the case with paragraphs (a) and (b) of section 260 of the Australian Act, paragraph (c) of section 260 should be read subject to the 'choice principle' established by the Australian courts. Thus if the taxpayers avail themselves of choice or courses of action which are intended to be opened to them by the provisions of the Act for the purpose of affecting their liability to tax, then section 260 of the Australian Act would not apply. For in such a situation there is no avoidance of tax. As noted earlier, it is not clear how far the Malaysian courts will accept and apply the 'choice principle' as developed in *Keighery's* case[11] and expanded in *Mullens*[12] and *Slutzkin's* cases[13] and accordingly the matter must await a judicial determination on this point. It is however unlikely that the Malaysian courts will apply the 'choice principle' in such a manner as to circumscribe the operation of section 140 of the Malaysian Act as a provision designed to combat tax avoidance.

Hindering or Preventing the Operation of the Act

In *Hancock* v. *Federal Commissioner of Taxation*[14] Dixon C.J. was of the view that the expression 'preventing the operation of the act in any respect' meant :

> ". . . the operation which the act would have in a given case if it were not for the contract, agreement or arrangement made for the purpose (or having the effect of preventing it . . ."[15]

Paragraph (d) of sections 260 and 140 of the Australian and Malaysian Acts respectively is not to be found in section 108 of the then New Zealand Act. As noted earlier,[16] the majority of the Privy Council in *Mangin's* case was of the view that the true reason for the omission of paragraph (c) of section 260 of the Australian Act from section 108 of the then New Zealand Act was probably that the paragraph was regarded as tautologous. The

[10]The present s. 99 of the New Zealand Income Tax Act is to the same effect. However, if the arrangement has two or more purposes or effects and one of its purposes or effects is tax avoidance, s. 99(1)(b) provides that the arrangement shall be avoided as against the Commissioner for income tax purposes even though the other purposes or effects are referable to ordinary business or family dealings.

[11](1957) 100 C.L.R. 66

[12](1976) 6 A.T.R. 504

[13](1977) 7 A.T.R. 166

[14](1961) 108 C.L.R. 258

[15]*Id.*, at p. 278

[16]See p. 23, above

context in which this observation was made suggests that a similar view may be taken of the omission of paragraph (d) of sections 260 and 140 of the Australian and Malaysian Acts respectively from section 108 of the then New Zealand Act. However Lord Wilberforce, who dissented, was of the view that paragraphs (c) and (d) of section 260 of the Australian Act (and for that matter section 140(1)(c) and (d) of the Malaysian Act) are wider than paragraphs (a) and (b) of sections 260 and 108 of the Australian and the then New Zealand Acts.[17] This observation of Lord Wilberforce could be said to be correct since paragraph (d) is worded generally and would probably cover cases where there is no specific purpose or effect of 'altering the incidence of any income tax.'

As with the preceding paragraphs of section 260, paragraph (d) of section 260 must be read subject to the 'choice principle' propounded by the Australian courts.[18]

(TO BE CONTINUED IN THE NEXT ISSUE OF JMCL)

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[17][1971] N.Z.L.R. 591 at p. 601; [1971] A.C. 739 at p. 755.

[18]I.C.F. Spry, *op.,cit.*, at p. 47.