

Client Alert

March 2017

Stamp Duty Remission - Negative Pledges in Loan Documentation

Introduction

Negative pledges have become commonplace in modern loan documentation, especially in facility agreements between banks and companies. Generally, negative pledges are negative covenants which often appear in security documents for unsecured loans, where they operate to prohibit the company to pledge any or some of its assets to other creditors or lenders. This is a common practice amongst Malaysian banks engaged in the area of corporate lending.

One pertinent issue surrounding negative pledges pertains to the stamp duty treatment over clean loan instruments, attached with negative covenants or negative pledges. In a recent case, Wong & Partners successfully represented a Taxpayer at the Court of Appeal, which clarified that a negative pledge does not amount to a security for the purposes of stamp duty in Malaysia.

We are pleased to share the decision by the Court of Appeal in this Client Alert.

Background Facts

The Taxpayer had obtained a loan ("**Facility Agreement**") from a Malaysian bank ("**Bank**"), which contained a negative pledge. Pursuant to the requirements of the Stamp Act 1949 ("**Stamp Act**"), the Taxpayer paid the Collector of Stamp Duty ("**Collector**") ad valorem stamp duty on the Facility Agreement, amounting to RM 1,980,000 pursuant to Item 22(1)(b) of the First Schedule of the Stamp Act.

Under the Stamp Duty (Remission) (No.2) Order 2012 ("**Remission Order**"), a taxpayer is entitled to a remission and refund of stamp duty paid in excess of 0.1% on a loan agreement or loan instrument which is subject to Item 22(1)(b) and is "*without security for any sum or sums of money repayable on demand or in single bullet repayment*".

Under the Remission Order, the Taxpayer made an application to the Collector for a remission and refund of 0.4% of the total stamp duty paid. The Collector denied the Taxpayer's application stating that it was not a "loan without security" due to the existence of a negative pledge in the Facility Agreement. The Collector took the view that a negative pledge was a "security" for the purposes of the Stamp Act. The Taxpayer appealed to the High Court, which held that a negative pledge was a security for the purposes of the Stamp Act. Unsatisfied, the Taxpayer engaged Wong & Partners and appealed to the Court of Appeal.

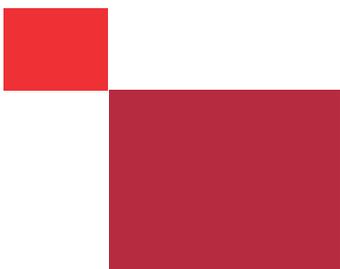
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The Court of Appeal's Decision

In its written submissions to the Court of Appeal, the Taxpayer made the following arguments, which we summarise as follows:

1. The negative pledge does not create an obligation to pay over any sums of money on demand, unlike a guarantee or other similar securities;
2. The negative pledge is not a security for which a sum or sums of money repayable on demand from the Taxpayer; and
3. The High Court had failed to consider the true and legal effect of the negative pledge. Although the Facility Agreement did stipulate the negative pledge as being one of the security to the loan, the true and legal effect of the negative pledge for the purposes of stamping is not. The High Court ought to have considered the true purpose of the negative pledge, and whether or not it created a "security for a sum or sums of money repayable on demand".

In handing down its decision verbally, the Court of Appeal had agreed with the arguments advanced by the Taxpayer, and overturned the High Court's decision in the Taxpayer's favour.

Conclusion and comments

Being the first case of its kind, the Court established a precedent on the nature of negative pledges. It is now clear that any negative pledges or negative covenants do not create a security over the loan for the purposes of stamp duty. The decision is a much welcomed one, and would certainly represent a significant relief to both borrowers and lenders in Malaysia.

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