



Court Of Appeal Rules Independent Director's Fees Are Business Income

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In a recent decision which was reverberated across boardrooms and tax department alike, the Court of Appeal in *OCP v Ketua Pengarah Hasil Dalam Negeri* held that the fees received by Independent Non-Executive Directors (INEDs) do not constitute employment income under the Income Tax Act 1967 (ITA). Instead, the court held that such income fell within the scope of business income.

The taxpayer in this appeal was successfully represented by the firm's Tax, SST & Customs partner, S. Saravana Kumar, together with associate, Felicia Wong.

Background

At first glance, the dispute appears technical- a contest between Sections 4(a) and 4(b) of the ITA. In reality, it raises a deeper question: can a statutory officeholder who is required by corporate governance rules to remain independent of management simultaneously be treated as an employee of the very company he oversees?

For years, the Inland Revenue Board (IRB) took the expansive view that any appointment carrying remuneration including an independent directorship amounted to "employment". The statutory definitions of "employer", "employee" and "employment" in Section 2 are indeed broadly framed. The IRB relied heavily on this breadth, arguing that the holding of a statutory office under the Companies Act 2016 was sufficient to trigger employment status for tax purposes.

The taxpayer in the case, an INED of several public-listed companies between 2002 and 2012 had channelled his directors' fees to management companies he established.

These receipts were returned as business income under Section 4(a), while he drew a fixed salary from the management companies and declared that salary as personal income. The arrangement had been accepted by the authorities for years.

Following an audit in 2015, the IRB reversed course. It contended that the director's fees received by the taxpayer should be taxed directly in the individual's hands as employment income under Section 4(b), reopening earlier years and imposing penalties on the basis of alleged negligence.

Court Rulings

The Special Commissioners of Income Tax sided with the IRB. The High Court did not. Nor did the Court of Appeal, which dismissed the IRB's appeal in full.

The Court of Appeal's reasoning, though not yet set out in written grounds, appears to rest on a simple but powerful proposition: independence and employment are conceptually incompatible in this context.

Under the listing requirements of Bursa Malaysia, an independent director must be free from management control and from relationships that could interfere with the exercise of independent judgment. An INED does not operate under day-to-day supervision, is not bound by internal employment manuals, does not receive employment benefits, and is not subject to the kind of control traditionally associated with a contract of service.

The High Court had applied orthodox common law principles, notably the "control test" and concluded that the hallmarks of employment were absent. It also held that directors' fees, determined by shareholders in general meeting, are not equivalent to wages paid under a contract of service.

The Court of Appeal affirmed the High Court's decision in rejecting the IRB's emphasis on administrative form. The issuance of Form EA and the deduction of monthly tax were treated by the IRB as decisive indicators of employment. The court disagreed. Reporting instruments cannot determine the legal character of income. To allow payroll forms to dictate substantive tax treatment would invert the hierarchy between law and administration.

Commentary

The broader significance of the decision lies in its insistence on coherence between tax law and corporate governance. Company law recognises INEDs as independent fiduciaries, appointed precisely to stand apart from management. To recast them as employees for tax purposes would create a conceptual contradiction: a director deemed independent for governance but subordinate for taxation.

For INEDs, the practical consequences are immediate. Directors' fees and allowances received by INEDs can be treated as business income under Section 4(a). Payroll-style deductions such as EPF, SOCSO and monthly tax deductions should no longer apply. Compliance obligations shift towards the self-assessment framework, including instalment payments and the filing of Form B.

For public-listed companies, the ruling introduces both clarity and administrative adjustment. Annual statements summarising fees may replace employment-style reporting. Boards may wish to revisit internal processes to ensure that tax treatment aligns with the court's reasoning if an INED wishes to have his or her director's fees and allowances treated as business income.

More broadly, the judgment signals judicial resistance to overly expansive interpretations of statutory definitions when they collide with commercial and governance realities. It affirms that the mere holding of a statutory office does not automatically create employment income, and that substance prevails over administrative practice.

In doing so, the Court of Appeal has not merely resolved a tax technicality. It has reinforced the conceptual boundary between oversight and management and ensured that the tax system respects it.

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