

**TECHNICAL**

---

**Direct Taxation**

**TAX CASE UPDATE**

**Provision for doubtful debt – whether deductible.**

**SASTEP SDN BHD v KPHDN**

High Court of Sabah & Sarawak at Kuching

Appeal No: KCH-14-1/1-2017

Date of Judgment: 31 May 2017

**Facts and Issues:**

This is an appeal against the decision of the Special Commissioners of Income Tax (SCIT) who had dismissed the Appellant's appeal against the respondent's ("Revenue") rejection of its claim for deductions for doubtful debts amounting to RM3.2 million for year of assessment (YA) 2001 and YA 2002 under S34(2) of the Income Tax Act 1967 (ITA).

(All sections cited hereinafter are from the ITA unless otherwise stated.)

The Appellant's main activity was in timber trading and equipment rental but had been dormant from 31.3.2002. In 1997, it rented equipment to Sarawak Pulp Industries Sdn Bhd (SPI) which was unable to pay the debt owing amounting to RM 3.2 million. Following a field audit of the Appellant's accounts by Revenue, a decision was made by Revenue to disallow the provision for doubtful debts for the outstanding sums for YA 2001 and YA 2002. Subsequently, Revenue issued 2 additional assessments via 2 Forms JA dated 29.7. 2009 to the Appellant. The Appellant then appealed to the SCIT against the assessments for YA 2001 and YA 2002, which appeal was dismissed on grounds which included the following:

- The Appellant did not take prudent action to recover the outstanding debt.
- The Appellant's action in writing off the debt was not based on prudent commercial considerations and not in its own interest because the Appellant and the debtor (SPI) shared a common director (named in the judgment and referred to hereinafter as "TPK").
- The SCIT were satisfied that Revenue had considered all the facts and circumstances of the case in imposing penalties for YA 2001 and YA 2002.

The issues for determination of the High Court ("the Court") were:

1. Whether the specific provision for doubtful debts amounting to RM3.2 million for YA 2001 should be allowed under S34(2);
2. Whether Revenue was entitled to impose penalties on the assessments for YA 2001 (original and additional) and YA 2002 (additional).

**Decision:**

Appeal dismissed. The grounds of the decision are summarized below:

1. The Appellant submitted that it had taken all reasonable action to recover the outstanding debt due from SPI, but was unable to do so. SPI could not pay the debt because there was a serious economic crisis in 1997 and 1998 which affected the whole world including Malaysia.

As it had utilized all means to recover the debt, the debt was deemed to be wholly irrecoverable, and should be allowed under S34(2). Penalties imposed under S113(2) should be waived as the Appellant had acted in good faith and disclosed all information relating to the doubtful debt. It was also submitted that the SCIT had made an error of fact in holding that TPK was a director of the Appellant as there was no evidence to show that he was holding that position. It was submitted that TPK was only acting as an officer of the Appellant in signing the documents relating to the Appellant.

2. Revenue submitted that the decision to write off the doubtful debt was not made in the interest of the Appellant but only because both companies shared the same director. Hence, the write-off was not done for the purpose of the business, and was not based on prudent commercial considerations. It was also submitted that legal action to recover the debt which only began in 2013 after the debt became time barred, showed that it was only done for purpose of the tax appeal. On the imposition of penalty, it was submitted that the penalty imposed was correct in law because the Appellant had made an incorrect return and this was only discovered during the field audit.
3. Whether a debt is wholly or partly (and to what extent) irrecoverable and thus qualifies as a deduction under S34(2) is in every case a question of fact (*Dinshaw v Bombay CIT [1933-34] 50 LTR*).
4. It was an agreed fact that the Appellant's principal activity was in timber trading and equipment rental, but no evidence was adduced by the Appellant to establish that there was such a transaction between the Appellant and SPI, and that it was genuine. No lease or rental equipment agreement entered into between the Appellant and SPI was exhibited, and no documents were produced to provide details such as total lease rentals, monthly or yearly amount of lease payments, length of lease, etc. Based on the documents available, the Appellant also did not provide relevant information like when SPI defaulted on the rental payments, whether any (or what) action was taken to recover the arrears, how long it took for the unpaid amount to accumulate to RM 3.2 million, etc.
5. Based on the documents exhibited, the first 2 letters of demand were sent in the year 2000. Several letters of demand were sent before the Appellant finally filed a suit against SPI in 2013, "*after 13 years of sending letters of demand, bearing in mind the Appellant leased the equipment to SPI in 1997.*" Pursuant to "proved facts" the Appellant did not pursue the action as it was already time barred. "*Clearly the Appellant delayed in taking the necessary action to recover the debt for obvious reasons.*"
6. It was submitted by the Appellant that the SCIT had erred in ruling that the Appellant and SPI shared a common director, namely TPK. Based on the audited accounts of the Appellant as at 31.3.2001 and the audited accounts of SPI as at the same date, the Court agreed that TPK was not a common director of both companies (but only a director of SPI). However, even though the SCIT had erred in this finding of fact, the Court averred that "*based on the facts and circumstances of the case as stated, there was no real prejudice and no miscarriage of justice against the Appellant.*"
7. Based on the 2 sets of accounts, although TPK was not a director of the Appellant but only of SPI, he had substantial financial interest in both companies as well as in the holding company. Hence dealings and financial transactions between these companies were transactions between related parties and were noted in the accounts as such. This could give rise to conflict of interest in the financial management of both companies by TPK. The Court noted that "*clearly, the Appellant had delayed in taking actions to recover the debt owed by SPI and in writing off the debt. These decisions were not made bona fide.*" It was the Court's view that there was ample material for the SCIT to rule that these decisions were not based on prudent commercial business considerations.
8. On the issue of penalties imposed, the conclusions drawn as stated above (that the

appellant's decision relating to action taken to recover and write off the debt were not made bona fide) were reiterated. The Court noted that the facts showed that Revenue had conducted a field audit on the Appellant as a result of which it was discovered that the Appellant had submitted an incorrect return because it had wrongfully deducted the debt as a deduction under S34(2). The SCIT had ruled that they were satisfied that Revenue had considered all the facts and circumstances of the case in imposing the penalty, which was justified, reasonable and valid. They also ruled that based on the record, there was no reason to disturb this discretionary power of Revenue. It was the Court's view that there was ample material for the SCIT to come to that ruling.

Members may read the full [Judgment](#) at the [www.highcourt.sabah.sarawak.gov.my](http://www.highcourt.sabah.sarawak.gov.my) website.

**Disclaimer**

This document is meant for the members of the Chartered Tax Institute of Malaysia (CTIM) only. This summary is based on publicly available documents sourced from the relevant websites, and is provided gratuitously and without liability. CTIM herein expressly disclaims all and any liability or responsibility to any person(s) for any errors or omissions in reliance whether wholly or partially, upon the whole or any part of this E-CTIM.