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TECHNICAL

Direct Taxation

TAX CASE UPDATE

Claim for Fees Paid to "Runners" under S33(1) of the Income Tax Act 1967.

SENTIMAS SDN BHD v KPHDN

High Court of Malaya in Kuala Lumpur
Civil Appeal No: No. 14-2-01/2017
Date of Judgment: 11 August 2017

Facts and Issues:

The Appellant, Sentimas Sdn Bhd (SSB) is appealing against the decision of the Special Commissioners of Income Tax (SCIT) made in a Deciding Order dated 20/5/2016, wherein the SCIT had unanimously disallowed the appeal by SSB against the assessment raised by the Respondent (DGIR) for the year of assessment (YA) 2009. The SCIT had held that –

i. the sum of RM 2.5 million ("the said sum") which was claimed as "express custom duty" by SSB is not allowable under S33(1) of the Income Tax Act 1967 (ITA) as it was not incurred wholly and exclusively in the production of gross income of SSB;
ii. the imposition of penalty under S113(2) of the ITA by the DGIR is correct in law.

(All sections cited hereinafter refer to sections in the ITA unless otherwise stated.)

The following are the salient facts of the case –

SSB is a company carrying on business as importer and dealer of reconditioned motor vehicles. The imported vehicles are stored in a warehouse and retrieved when there is a buyer. "Runners" are appointed by SSB to handle matters pertaining to clearance procedures with Customs and Puspakom.

During a tax audit of SSB's accounts conducted by the Inland Revenue Board ("Revenue") in 2012, it was found that among the expenses claimed was an amount of RM 89.3 mil. described as "Purchases" in the Trial Balance. It was discovered that included in that amount were expenses on "express customs duty" (ECD) amounting to RM 2.5 mil. which was paid and claimed earlier in SSB's Trial Balance. SSB had failed to produce any receipt from the Customs Dept ("Customs") relating to that payment.

The appellant claimed that expenses on ECD were actually payments to 'runners' to handle the movement of cars from Port Klang to SSB's showroom. However, such payments to runners were not shown anywhere in the ledger. No receipts from Customs were produced because the payments were not made to Customs but to the runners, in cash.

The existence of runners was never made known to Revenue during the audit, or at the audit interview, or before the assessment was raised.

Decision:

The High Court ("the Court") held that the SCIT were correct in holding that the said sum is not allowable under S33(1) and the penalty imposed on the Appellant under S113(2) is reasonable and in accordance with the law.

The grounds of decision are summarized below:

1. In relation to the role of the appeal court, the Court referred to various legal precedents[1] wherein legal principles relating to the law of appeal were established, and arrived at the following conclusion:

   "*In short, what it means is an appeal against the decision of the SCIT can only be set aside if the Court is satisfied that:*
   (a) the SCIT had erred in law;
   (b) the decision of the SCIT is not consistent with their finding of facts; or
   (c) *there is no evidence to support the decision of the SCIT*. "

2. The Court made the following statement pertaining to the issue under appeal –

   "*The issue before the SCIT is different from the issue raised by the Appellant in this appeal. The record shows that the issues raised by the Appellant during the trial before the SCIT was (sic) different from the issue raised in Form Q…."*

   and went on to discuss that further (see following points).

3. Before the SCIT, the issue was whether ECD amounting to RM 2.5 mil. incurred in YA 2009 is deductible under S33(1). The SCIT had decided, based on the evidence before them, that the expense is not deductible under S33(1) "*by reason that it is not revenue (expenditure*)".

   Before the (High) Court, the issue is whether the amount in question, being "*fees paid to 'Runners' (for a specific) job function……is incurred 'as outgoings wholly and exclusively in the production of income' under S33(1), ITA."*

   "*The issue is different* (changing) *from one* (that relates to) *expenditure for ECD incurred to …..'fees paid to Runners'. I agree with the Respondent that the Appellant was trying to* (mislead) *the SCIT by introducing new issues*."

4. Instead of presenting proof that ECD was paid to Customs, the Appellant had tried to adduce other evidence by calling the runners to give statements during the trial. This was an afterthought, as found by the SCIT in the Case Stated.

   DGIR contended that there was never any disclosure about the existence of runners during the audit process and appeal period, but the issue only came up during the trial. The Judge agreed with DGIR that calling the runners to give evidence relating to expenses on ECD cannot be a justification for the said expenses to be allowed.

5. The issue involving fees paid to runners is also brought before the High Court. The Judge's view on this is –

   "I do not think it is fair to allow the Appellant to bring a new issue at this stage when the SCIT had made a finding of facts (sic) based on the issue before it and had made a decision that the claim for expenditure 'ECD' of (RM 2.5 mil) *is not allowable* (under S33(1) of ITA)."

6. The Judge also made a remark that, had the Appellant declared the said sum as fees paid to runners in its accounts instead of "*maneuvering it as expenditure for 'ECD'*" (which the Appellant had claimed to be a mistake) and produced the relevant supporting documents, "*the case would have been different*".

7. The SCIT had made a finding of fact that nowhere in the Appellant's ledger was it shown that the said payment was made to runners. It was also proven that the Appellant had failed to

produce any receipts from Customs in respect of ECD, as the payment (in cash) was not made to Customs but to the runners.

8. Under para. 13 of Sched. 5, the onus to prove that an assessment is excessive is on the Appellant. In this case, the onus is on the Appellant to prove that the said sum was actually paid to the Customs, and to show that the Appellant was "under an obligation to pay" the said amount (*Exxon Chemical (M) Sdn Bhd v KPHDN (2006) 1 MLJ 428*), and that it was incurred wholly and exclusively in the production of its gross income. As stated above, the Appellant had failed to produce the evidence to discharge the burden of proof.
9. With regard to the runners who were called as witnesses, it was for the SCIT to determine whether their statements were acceptable, and (as stated in the Case Stated) the SCIT did not find the witness' statements as credible statements. The SCIT had also made a finding of fact that the statements by all the runners were "*merely circumstantial*" as they were unable to determine how much fees were received or how many cars were serviced. The Judge agreed that their evidence should not be admissible for purpose of this appeal.
10. Another finding of fact by the SCIT was that the Appellant had failed to prove that the said sum was actually received by the runners. The Judge agreed with DGIR's contention that the payment to Customs and related expenses were "*claimed earlier by the Appellant and allowed by the Respondent. Therefore, there is no reason for the Appellant to claim it once more*".
11. In the circumstances of this case, the Court agreed with the finding of the SCIT, that penalty was correctly imposed on the Appellant.

[1] The cases referred to are:
Chua Lip Kong v DGIR (1982) 1 MLJ 235
Edwards' v Bairstow (1956) AC 14
Lower Perak Co-operative Housing Society Bhd v KPHDN (1994) 2 MLJ713

Members may read the full Grounds of Judgment at the Institute's website and the LHDNM website.