

TECHNICAL

Direct Taxation

TAX CASE UPDATE

Whether additional assessments issued according to the “best...judgment” of the Director General of Inland Revenue (DGIR) were incorrect and excessive

[Ketua Pengarah Hasil Dalam Negeri v Lai Keng Chong & Kong Chee Leong](#) (CA)

2012 (Civil Appeal No: J-01-211-2010)

Date of Judgment: 30 January 2012

Facts:

The taxpayers (Respondents) operate a business under the name of “Hup Soon Trading”, the main activity of which is trading in all forms of scrap ferrous metals such as wire, battery, drums, irons, etc. They had submitted their return forms for years of assessment (YA) 1998 to 2001 and declared that the gross profit ratio (GPR) for the relevant YA were 28.33%, 26.84%, 16.79%, and 15.81% respectively.

As a result of a field audit conducted by the Inland Revenue Board (IRB) on Hup Soon Trading in respect of YA 1998 to 2001, it was found that there were many failures in the accounting system, including the failure to record all business transactions, failure to keep records of trading, and failure to declare income from crane rental for the relevant YA. According to the DGIR,

- the taxpayers had under declared their income for YA 1998 to 2001; and
- Invoices and delivery orders were not available for all the relevant periods as they were destroyed by pests or misplaced, except for YA 2001.

The taxpayers agreed with the findings of the audit and the additional taxes and penalties imposed by the IRB based on a GPR of about 4%.

After the audit, the taxpayers submitted audited accounts (the revised accounts”) for the year ended 2001 and claimed that it was accurate because it was based on the actual sources of documents. Based on the revised accounts for the year 2001, the gross profit ratio was 7.78%. However, they were rejected by IRB on the basis that they were not accurate and unreliable. Subsequently, IRB revised its computations, using a GPR of 22% for all the relevant years. This is the average rate obtained by taking the total gross profit declared by the taxpayers in their first return forms and dividing that figure by 4 (number of years from 1998 to 2001). The taxpayers disagreed, claiming that the profit margin was only 7% - 8% and hence filed Form Q on 6.2.2004.

Issue:

The **issue for determination of the Special Commissioners of Income Tax (SCIT)** is whether the GPR of 22% used by the IRB in raising the notices of additional assessment for YA 1998, 1999, 2000 (current year tax assessment) and 2001 were incorrect and excessive. The SCIT held that the said GPR is correct in law.

Decision of Special Commissioners of Income Tax:

The burden is on the taxpayers to prove that the assessment is erroneous or excessive. If they failed to do so, then the assessment stands. The SCIT had considered the following:

- The taxpayer testified that the percentage profit of his business is between 3% - 5%. The SCIT cannot rely solely on his evidence as his accounts were not properly kept.
- The accountant who had prepared the revised accounts for the year of 2001 based on the documents provided by the taxpayers, testified that based on the revised accounts, the gross profit ratio for that year was 7.78%. The SCIT cannot accept the revised accounts to show the correct gross profit ratio because it was found that the taxpayer never had complete records of his business for the relevant years of assessment during the tax audit and the revised accounts is in mistrust as it had been derived from a cross reference with a third party.
- The witness who had a business similar to the business of the taxpayer testified that the gross profit margin of his business is between 5% - 8%. The SCIT cannot accept the evidence and other comparisons to show the gross profit ratio of the taxpayer's business because of the place of business, the amount of turnover, the cost of business operations and the size of the business are not similar. It is not a good comparison for the SCIT to rely on as guidance to determine the gross profit ratio of the taxpayers.
- From the Revenue's data warehouse, the gross profit ratio of similar business is between 1.4% to 47.22%, and in Johor the ratio is higher, between 1.99% and 50.02%.

Therefore the best evidence for SCIT to rely on is the first return submitted by the taxpayer when it was first submitted which show the gross profit ratio of between 15.81% to 26.84%.

Hence, the appeal was dismissed by SCIT and the IRB assessment affirmed.

Decision of High Court:

The taxpayers then appealed to the High Court, which allowed the appeal and held that the GPR of 22% was incorrect and excessive. The High Court applied the GPR of 8% to the years of assessment under consideration. The High Court held that the SCIT had misdirected themselves in law on the following grounds:

- a. The SCIT had merely accepted that the DGIR had found that the said revised account was not accurate and unreliable but no evidence was referred to by the SCIT;
- b. DGIR, having imposed additional tax liability on the taxpayers based on a GPR of about 4%. after the tax audit, cannot now revise the computation to apply the GPR of 22% which is based on the taxpayers' first return forms;
- c. It is clearly capricious on the part of DGIR to use figures which he himself had acknowledged, was wrong for deriving the GPR;
- d. Therefore it cannot be said that the DGIR had issued the notices of additional assessment according to the "best judgment" of the DGIR as provided under [Section 91\(1\)](#) of the ITA.

Hence, the present appeal by the DGIR.

Decision of Court of Appeal:

Appeal allowed. Decision of High Court set aside and decision of SCIT reinstated.

Summary of Grounds of Decision:

1. The Court of Appeal ("the Court") had perused the evidence "with a fine toothcomb" and it is the Court's view that the SCIT had taken into consideration the evidence of the following –

- Lai Keng Chong (first Respondent), who testified that the profit rate of his business was between 3% - 5%. However, the SCIT declined to rely solely on his evidence because the accounts were not properly kept.
- The accountant who had submitted the accounts of the taxpayers for the relevant years, but admitted that the accounts were not verified. Revised accounts for the year 2001 were also prepared by him but were based on documents submitted by the taxpayers, which the accountant also did not verify. The SCIT had refused to accept the revised accounts as the field audit had revealed that the taxpayers never had a complete record of their business, and the revised accounts were derived from a cross reference with a third party, and was therefore “*in a state of mistrust*”.

The SCIT concluded that the best evidence for them to rely on was the first return submitted by the appellants (from which the GPR of 22% was derived). On that basis the SCIT “*accepted that the GPR of 22% as estimated by the taxpayers to be a fair estimate.*”

2. By contrast, the High Court’s decision simply stated the order “*that fresh notices for both appellants (now respondents) for the relevant years be issued on the basis of 8% which in my opinion is just and appropriate.*”

The Court was of the view that the High Court’s decision was not supported by evidence. “*The basis of GPR of 8% is only the opinion of the learned Judge of the High Court and it is without any basis.*”

3. It must be borne in mind that the doctrine of estoppel cannot apply to the DGIR (appellant) and no taxpayer can raise the defence of estoppel against the DGIR. (*Government of Malaysia v Sarawak Properties Sdn Bhd. [1994] 1 CLJ 514* and *Teruntum Theatre Sdn Bhd v KPHDN [2006] 3 CLJ 123, CA*)

Hence, it was the Court’s view that the “*GPR of 22% ...affirmed by the SC is just and appropriate pursuant to section 91(1) of the ITA and based on evidence.*”

Members interested may read the full judgement of the case at the various Courts:

- LKC & Anor v Ketua Pengarah Hasil Dalam Negeri, (SCIT) (2008) MSTC 3,765 [Appeal No. PKCP(R) 6/2005 and 7/2005],
- [Lai Keng Chong & Anor v Ketua Pengarah Hasil Dalam Negeri \(HC\) \(2010\)](#) MSTC 30-010 [Civil Appeal No. 14-1-2008], and
- [Ketua Pengarah Hasil Dalam Negeri v Lai Keng Chong & Anor \(CA\) \(2012\)](#) MSTC 30-042 [Civil Appeal No. J-01-211-2010].

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