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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].

DALAM MAHKAMAH RAYUAN MALAYSIA DI PUTRAJAYA
(BIDANG KUASA RAYUAN)
RAYUAN SIVIL NO: J-01-211-2010

ANTARA

KETUA PENGARAH HASIL DALAM NEGERI ----- PERAYU

DAN

(1) LAI KENG CHONG
(2) KONG CHEE LEONG ------ RESPONDEN-RESPONDEN

Dalam Perkara Mengenai Rayuan Sivil No. **MT(5)-14-1-2008**
Di dalam Mahkamah Tinggi Malaya di Johor Bahru

ANTARA

(1) LAI KENG CHONG
(2) KONG CHEE LEONG **....** PERAYU-PERAYU

DAN

KETUA PENGARAH HASIL DALAM NEGERI **....** RESPONDEN

Coram**:**

(1) Abdul Malik bin Ishak**,** JCA
(2) Mohamed Apandi bin Hj Ali**,** JCA
(3) Balia Yusof bin Hj**.** Wahi**,** JCA

ABDUL MALIK BIN ISHAK, JCA

DELIVERING THE JUDGMENT OF THE COURT

[1] This is the judgment of this Court. The facts have been sufficiently set out by the learned High Court Judge, the Special Commissioners of Income Tax (**"SC"**) and in the written submissions of the parties. We will not dwell on the facts at length.

[2] Suffice for us to state that the taxpayers (respondents) operate a business under the name and style of Hup Soon Trading and their principal activity is the business of trading in all forms of scrap ferrous metals such as wire, battery, drums, irons, steel aluminium, brass copper, plastics and crane metal. It is a flourishing business.

[3] The taxpayers (respondents) had submitted their return forms for the relevant years of assessment and declared that the gross profit ratio (**"GPR"**) for the relevant years of assessment were 28.33%, 26.84%, 16.79% and 15.81% respectively.

[4] On 31.3.2003, the Director-General of Inland Revenue (**"the DG (appellant)"**) conducted a field audit on Hup Soon Trading in respect of the years of assessment 1998, 1999, 2000 (Current Year) and 2001. And the DG (appellant) found that:

(a) the taxpayers (respondents) had not recorded completely all their business transactions**;**

(b) the taxpayers (respondents) failed to keep and retain their records of trading for the relevant years of assessment in good order**;**

(c) the taxpayers (respondents) did not declare their income of the crane rental for the relevant years of assessment**;** and

(d) the monies deposited into the taxpayers**'** (respondents') bank account were higher than the amount declared**.**

[5] According to the DG (appellant)**,** the taxpayers (respondents) had under declared their income for the relevant years of income tax for the following years**:**

(a) Year of assessment 1998 - RM16**,**549**,**443**.**27

(b) Year of assessment 1999 - RM15**,**103**,**940**.**98

(c) Year of assessment 2000 (Sistem Taksiran Tahun Semasa (**"STTS"**) or Current Year Tax Assessment) - RM21**,**270**,**204**.**19

(d) Year of assessment 2001 - RM23**,**213**,**112**.**01

[6] The field audit conducted by the DG (appellant) also revealed that invoices and delivery orders were not available for all the relevant periods

as they were destroyed by pests and/or misplaced save for the year of assessment 2001.

[7] In our judgment, by virtue of section 82(1)(a) of the Income Tax Act 1967, it is the statutory duty of the taxpayers (respondents) to keep all their records in order particularly receipts, payment vouchers, orders and a host of other related documents pertaining to their business enterprise for a period of seven (7) years for tax purposes and this statutory duty cannot be waived.

[8] The field audit that was done on 31.3.2003 showed that the taxpayers (respondents) failed to keep their records going back to 1996, which should have been done, bearing in mind the seven (7) years embargo.

[9] Now, this appeal before us is in regard to the decision of the High Court delivered on 5.3.2010 which allowed the appeal by the taxpayers (respondents) against the deciding order of the SC dated 29.5.2007.

[10] The deciding order was made solely with respect to the following issue framed for determination of the SC:

> **"Whether the 22% GPR used by the Revenue in raising the additional assessment for years of assessment 1998, 1999, 2000 (STTS) and 2001 on 9.1.2004 were incorrect and excessive?"**

[11] The SC held that the GPR of 22% used by the DG (appellant) was correct in law. The taxpayers (respondents) filed an appeal against the

deciding order and required the SC to state a case for the opinion of the High Court pursuant to paragraph 34 of Schedule 5 of the Income Tax Act 1967**.** After hearing the parties**,** the High Court allowed the appeal of the taxpayers (respondents) and dismissed the decision of the SC and held that the GPR of 22% used by the DG (appellant) was incorrect and excessive**.** The High Court applied the GPR of 8% to the relevant years of assessment under consideration**.**

[12] The High Court also held**,** inter alia**,** that**:**

(a) the DG (appellant) after having imposed the additional tax liability after the field audit that was carried out**,** cannot now revise their computation using an average GPR of 22% based on the first return forms and issue the notices of additional assessments to the taxpayers (respondents)**;**

(b) it is clearly capricious on the part of the DG (appellant) as it is using figures which the DG (appellant) had itself acknowledged to be wrong to derive the GPR**;** and

(c) therefore**,** the DG (appellant) cannot be said to have issued the notices of additional assessments according to the **"best judgment"** of the DG (appellant) within the meaning of section 91(1) of the Income Tax Act 1967**.**

[13] We have perused through the evidence with a fine toothcomb, and it is our judgment that:

(a) The SC took into consideration the evidence of Mr. Lai Keng Chong, the first taxpayer (first respondent), who testified that the percentage profit of his business was between 3% to 5% but the SC declined to rely solely on his evidence because the account was not properly kept.

(b) The SC also considered the evidence of the accountant who had submitted the accounts of the taxpayers (respondents) for the relevant years of assessment to the DG (appellant). But the accountant admitted that the accounts were not verified. And after the field audit, the accountant submitted a revised account for the year 2001 and based on this account the accountant testified that the GPR for that year was 7.78%. This revised account was prepared by the accountant based on the documents submitted by the taxpayers (respondents) but the accountant said that he did not verify the documents. The SC refused to accept the revised account in order to show the correct GPR of the taxpayers' (respondents') business because during the field audit it was found that the taxpayers (respondents) had never had a complete record of their business

for the relevant years under assessment. According to the SC, the revised account was in a state of mistrust as it was derived from a cross-reference with a third party, namely, Taiko Metal Sdn. Bhd.

(c) By way of a conclusion, the SC had this to say:

> **"Therefore the best evidence for us to rely is the first return submitted by the appellant (now respondent) when it was first submitted which show the GPR of between 15% to 26.84%. We therefore accepted that the GPR of 22% as estimated by the taxpayers to be a fair estimate."**

[14] In sharp contrast, the High Court held as follows:

> **"The deciding order dated 29.5.2007 as well as the notices of assessment for years of assessment 1998 to 2001 for the appellants (now respondents) are set aside and pursuant to paragraph 39(c) Schedule 5 of Income Tax Act 1967, I hereby order that fresh notices for both appellants (now respondents) for the relevant years be issued on the basis of GPR of 8% which in my opinion is just and appropriate."**

[15] With respect, we say that the decision of the High Court is not supported by any 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. It is simply plucked from the air. Whereas the basis of GPR of 22% imposed onto the taxpayers (respondents) and affirmed by the SC is just and appropriate pursuant to section 91(1) of the Income Tax Act 1967 and based on the evidence. It must be borne in mind that the doctrine of estoppel cannot apply to the DG (appellant) and no taxpayer can raise the defence of

estoppel against the DG (appellant) **(Government of Malaysia v. Sarawak Properties Sdn Bhd [1994] 1 CLJ 514;** and **Teruntum Theatre Sdn Bhd v. Ketua Pengarah Hasil Dalam Negeri [2006] 3 CLJ 123, CA).**

[16] For all these reasons**,** we unanimously allow the appeal of the DG (appellant) with costs of RM15**,**000**.**00**.** We set aside the decision of the High Court and re-instate the decision of the SC**.** Deposit**,** if any**,** to be refunded to the DG (appellant)**.**

30**.**1**.**2012

Dato' Abdul Malik bin Ishak
Judge**,** Court of Appeal**,**
Putrajaya

Counsel:

(1)	For Revenue/Appellant	**:**	Mr**.** Abu Tariq Jamaluddin with Mr**.** Norhisham Ahmad Lembaga Hasil Dalam Negeri Kuala Lumpur
(2)	For the Taxpayers/ Respondents	**:**	Dato' Sukhdev Singh Khandawa with Mr**.** Muhamed Fariz bin Mohd Ali
	Solicitor	**:**	Messrs Azlan Shah Sukhdev Advocates & Solicitors Kuala Lumpur

Cases referred to in this judgment

(1) **Government of Malaysia v. Sarawak Properties Sdn Bhd [1994] 1 CLJ 514.**

(2) **Teruntum Theatre Sdn Bhd v. Ketua Pengarah Hasil Dalam Negeri [2006] 3 CLJ 123, CA.**