LHAG CELEBRATES 25TH ANNIVERSARY

Special Issue on GST

Legal Herald

FEBRUARY 2018

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Unravelling Best Judgment Assessment Under the GST Act 2014

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KDN PP 12853/07/2012 (030901)

Best judgment assessment is a prominent feature of tax legislation in the Commonwealth including Malaysia. The idea behind the best judgment assessment provision is that it should be invoked by tax authorities when dealing with uncooperative and recalcitrant taxpayers.

The authors will examine s 43(1) of the Goods and Services Tax Act 2014 ("GST Act") by discussing the circumstances in which the Royal Malaysian Customs Department ("Customs") may raise a best judgment assessment based on landmark cases from the UK.

Section 43(1)

The section essentially provides that the Director General of Customs ("DGC") may issue a best judgment assessment where a taxpayer:

(a) fails to apply for registration under s 21 of the GST Act;

(b) fails to furnish a return under s 41 of the GST Act; or

(c) furnishes a return which to the DGC appears incomplete or incorrect.

Printed by One2Print Sdn Bhd
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Additionally, the DGC may also impose a penalty under s 41(8) of the GST Act. The best judgment assessment must be notified in writing to the taxpayer.

Very clearly, in order for the DGC to invoke s 43(1), the first requirement must be that the taxpayer must have either:

(a) failed to apply for registration under s 21 of the GST Act;

(b) failed to furnish a return under s 41 of the GST Act; OR

(c) furnished a return which to the DGC appears incomplete or incorrect.

Once this has been established, the second requirement is whether the assessment raised is to the best of the DGC's judgment. There is no Malaysian case law on this point as yet, hence the reference to the UK cases.

UK Position

The UK has similar best judgment assessment provisions under s 73(1) of the Value Added Tax Act 1994 and the then s 31(1) of the Finance Act 1972. The core of this article will primarily revolve around three cases:

(i) *Van Boeckel*,[1] which provides that an assessing officer will have made an assessment to the best of his judgment so long as it was honest, *bona fide*, reasonable and not arbitrary;

(ii) *Rahman (No 2)*[2] and the adoption of the two-stage approach; and

(iii) *Pegasus Birds*,[3] particularly in relation to the role of a tribunal in determining an appeal against a best judgment assessment.

Van Boeckel's case

The taxpayer relied on a manager to run a public house and based his VAT returns on the takings submitted by the manager. Customs officers visited the taxpayer's premises and inspected the relevant documents. It appeared that the taxpayer's VAT returns were incorrect as he had failed to declare or fully account for the full value of the supplies made to him. The taxpayer suggested pilferage as a possible cause of the discrepancy. The officers did not speak to the manager nor did they visit the premises during office hours. They noted the takings of the business over a five-week period and, on that basis, the commissioners assessed the amount of tax due.

The issue that arose was whether the commissioners had complied with the requirement that the assessment must be for the amount of tax which, to the best of the commissioner's judgment, was due from the taxpayer. The taxpayer argued that firstly, the commissioners made no sufficient attempt to investigate the possibility of pilferage of stock; and that secondly, the assessment was based on an insufficiently long and representative period of the taxpayer's business. The frequently cited judgment of Woolf J in this case forms the starting authority as to what constitutes best judgment and how to identify what obligations are placed on the commissioners in assessing the amount of tax due.

Duty to investigate

In making an assessment to the best of their judgment, the commissioners must make a value judgment on the material before them. Naturally, there must be at least *some* material on which they can base their judgment, as observed by Woolf J:

> "What the words 'best of their judgment' envisage, in my view, is that the commissioners will fairly consider

1 *Van Boeckel v Customs and Excise Commissioners* [1981] STC 290 ("*Van Boeckel*")
2 *Rahman* (*trading as Khayam Restaurant) v Customs and Excise Commissioners (No 2* [2003] STC 150 ("*Rahman (No 2*)")
3 *Customs and Excise Commissioners v Pegasus Birds Ltd* [2004] STC 262 ("*Pegasus Birds*")

> all material placed before them and, on that material, come to a decision which is one which is reasonable and not arbitrary as to the amount of tax which is due. As long as there is some material on which the commissioners can reasonably act, then they are not required to carry out investigations which may or may not result in further material being placed before them."[4]

On this basis, Woolf J rejected the taxpayer's argument that there had been no real investigation into the manner in which the business was run as the officers had neither interviewed the managers nor visited the premises when it was open. While this may seem unfair from the taxpayer's perspective, Woolf J reasoned that assessing officers are not required to carry out exhaustive investigations to determine the amount of tax due as the primary obligation of making accurate returns, under the law, is on the taxpayer.

Honest and *bona fide*

Besides making a value judgment on material before them, "best judgment" also necessarily requires the commissioners to act honestly and *bona fide*:

> "Clearly they must perform that function honestly and *bona fide*. It would be a misuse of that power if the commissioners were to decide on a figure which they knew was, or thought was, in excess of the amount which could possibly be payable, and then to leave it to the taxpayer to seek, on appeal, to reduce that assessment."[5]

An assessment is honest and *bona fide* when it is not made "dishonestly, or vindictively or capriciously",[6] and when it is not "some spurious estimate or guess in which all elements of judgment are missing",[7] or "wholly unreasonable".[8]

Thus, it appears that the focus of best judgment is not on the objective correctness of the assessment of tax due, but on whether the assessment has been made honestly with at least some basis for it. Woolf J highlights in his judgment that it was perfectly acceptable for the commissioners to base their assessment on only a five-week test period, indicating that a disagreement by the taxpayer as to the method of assessment or the existence of alternative calculation methodologies did not immediately lead to the conclusion that the assessment was not made to best judgment.

The fact that the tribunal made a reduction in relation to the amount of assessment also does not mean that the validity of the assessment was called into question. In other words, the fact that there are different conclusions that can be drawn by different individuals from the same set of facts and circumstances does not mean that the commissioners did not make the assessment to the best of their judgment.

Rahman (No 2)'s *case*

In the subsequent cases after *Van Boeckel,* it has become the norm for tribunals to adopt a two-stage approach in addressing best judgment appeals by clearly distinguishing between the validity and the amount of the assessment.

Two-stage approach

This distinction appears to arise out of the interpretation of s 83(p) of the VAT Act 1994, which provides for an appeal "with respect to… an assessment under section 73(1)*" and "*with respect to… the amount of such an assessment*"*. Chadwick LJ in *Rahman (No 2)*'s case explained that there are two considerations arising out of this: firstly, whether the assessment has been made under the power conferred by the section and secondly, whether the amount of the assessment is the correct amount of tax payable by the taxpayer.

4 *Supra* n 1, at 292
5 *Ibid*
6 *Supra* n 1, citing *Commissioner of Income Tax, United and Central Provinces v Badridas Ramrai Shop* (1937) 64 LR Ind App 102
7 *Supra* n 1, citing *Argosy Co Ltd v Inland Revenue Commissioner* [1971] 1 WLR 514
8 *Supra* n 1, at 297

The first consideration itself involves two further elements, that is, whether the pre-condition to the exercise of the power is satisfied (e.g. in relation to s 43(1) of the GST Act, whether a taxable person fails to register for GST or to furnish a return, or furnishes a return which to the Director General appears incomplete or incorrect) and whether the assessment was made to the best of their judgment.

As the first element is rarely in dispute, the two-stage approach essentially requires the tribunal to first consider whether, on the material available to the commissioners at the time the assessment was made, the assessment satisfies the best judgment test. If the test is satisfied, the tribunal will then consider, as a second stage in the appeal, whether the amount of the assessment should be varied.

Best judgment

Chadwick LJ provided further guidance on the principles expounded by Woolf J in *Van Boeckel*. He highlighted that the adoption of a different calculation methodology, one that was "rough and ready", does not lead to the conclusion that the commissioner's judgment was flawed or outside the margin of discretion given to him. It also does not follow that when the tribunal has reached a figure for the payable VAT that differs from what the commissioners have assessed, the assessment was not made to the best of the commissioners' judgment, although he held that the discrepancy does require some explanation.

Chadwick LJ sets out three possible explanations as follows:

> "[1] The explanation may be that the tribunal, applying its own judgment to the same underlying material at the second, or "quantum", stage of the appeal, has made different assumptions… from those made by the commissioners. As Woolf J pointed out in *Van Boeckel*… that does not lead to the conclusion that the assumptions made by the commissioners were unreasonable; nor that they were outside the margin of discretion inherent in the exercise of judgment in these cases.
>
> "[2] Or the explanation may be that the tribunal is satisfied that the commissioners have made a mistake — that they have misunderstood or misinterpreted the material which was before them, adopted a wrong methodology or, more simply, made a miscalculation in computing the amount of VAT payable from their own figures. In such cases… the relevant question is whether the mistake is consistent with an honest and genuine attempt to make a reasoned assessment of the VAT payable; or is of such a nature that it compels the conclusion that no officer seeking to exercise best judgment could have made it.
>
> "[3] Or there may be no explanation; in which case the proper inference may be that the assessment was, indeed, arbitrary."[9]

Hence, it is clear that there is substantial discretion for the commissioners to make an assessment to the best of their judgment and that validity will rarely be affected as long as there has been some basis or explanation for making the assessment, even if that explanation is one of miscalculation, misinterpretation or mistake.

Amount of tax

Given the commissioner's considerable discretion in making an assessment, Chadwick LJ cautions against "an over-rigid two-stage approach" by citing with approval the following passage by Carnwath J in *Rahman (No 1)*:[10]

> "I do not wish to diminish in any way from the importance of guidance given by Woolf J [in the *Van Boeckel* case] to Customs officers as to how to exercise their best judgment when making assessments. However, when the matter comes to the tribunal, it will be rare that the assessment can justifiably be rejected altogether on the ground of a

9 *Supra* n 2, at 165
10 [1998] STC 826 at 840

> failure to follow that guidance. The principal concern of the tribunal should be to ensure that the amount of the assessment is fair, taking account not only the commissioners' judgment but any points raised before them by the appellant."

Instead of focusing solely on determining whether an assessment has been made to best judgment, the tribunal should instead concentrate on the question of what amount of tax is properly due from the taxpayer on the material before it. Chadwick LJ goes as far as to say that even in cases where it may be proper to discharge the assessment (i.e. where it was not made to best judgment), the tribunal may choose to instead give a direction specifying the correct amount of tax payable, with the consequence that the assessment would have effect as an assessment of the amount specified in the direction. His Lordship justifies this by referring to the intention of the legislature, as the "underlying purpose of the legislative provisions is to ensure that the taxable person accounts for the correct amount of tax".[11]

It is worth noting that the powers of the tribunal to give a direction specifying the correct amount of tax on appeal against an assessment were prescribed by legislation, specifically s 84(5) of the VAT Act 1994.

The Malaysian GST Act contains a broader provision as to the powers of the GST Appeal Tribunal. Section 144(2) provides that the tribunal shall have the power to affirm or vary the decision of the DGC or to set aside the decision and substitute for it a new decision. Hence, it appears that the Malaysian GST Tribunal is suitably vested with powers by the legislature and is able to adopt the approach taken in *Rahman (No 2*) in relation to appeals against best judgment assessments.

Pegasus Birds

This case reinforces Chadwick LJ's position in *Rahman (No 2)* in holding that an assessment will not be set aside in all but very exceptional cases, and that the tribunal's primary task is to find the correct amount of tax, so far as possible on the material properly available to it. His Lordship stresses that the tribunal should not automatically regard an appeal against a best judgment assessment as an appeal against the assessment as such, rather than against the amount. The court set a high threshold in relation to the validity of the assessment in that the assessment can only be set aside if the justice of the case demands it:

> "[E]ven if the process of assessment was found defective in some respect applying the established test, the question remained whether the defect was so fundamental that justice required the whole assessment to be set aside, or whether justice could be done simply by correcting the amount to what the tribunal found to be a fair figure on the evidence before it."[12]

Hence, it appears that only an assessment tinged with dishonesty or some element of fraud will not have been made to best judgment. The approach adopted in *Pegasus Birds*, in effect, widens the interpretation of "to the best of their judgment" in *Van Boeckel*. Even if the assessment as viewed objectively was "wholly unreasonable" or there had been a failure to consider all the relevant material, the relevant question in determining whether an assessment has been made to best judgment remains whether there has been an "honest and genuine" attempt at the time of assessment:

> "It is open to a tribunal to find that it is so unlikely that an experienced officer of Customs and Excise, seeking to make a proper assessment of the VAT properly due, would have made an assessment in the amount that he did that the proper inference to draw is that, in making that assessment, he could not have been doing his honest best. But that is an evidential inference from the facts; it is not a finding that because (although doing his honest best) his assessment fell below an objective standard of reasonableness, he failed to exercise the power to assess to the best of his judgment as a matter of law."[13]

11 *Supra* n 2, at 152 to 153
12 *Supra* n 3, per Carnwath LJ at 1518 to 1519
13 *Supra* n 3, per Chadwick LJ at 1530

Pegasus Birds makes it clear that given this high threshold and the difficulty of surpassing it, the tribunal's primary task is to find the correct amount of tax, so far as possible on the material properly available to it, reiterating the approach suggested in *Rahman (No 2)*.

Conclusion

The cases above demonstrate the wide powers that the DGC, like the commissioner, has in relation to determining an assessment. As long as there has been an honest and genuine attempt at evaluating the amount of tax due, the cases indicate that a mistake or the application of an unsuitable calculation methodology by the assessing officer will not render the assessment invalid. However, these cases clearly illustrate that the tribunal is vested with sufficient authority to vary the amount of assessment or tax demanded based on the information available either before the commissioners during the course of tax audit or before the tribunal during the course of the hearing.

This is evident from the recent UK case of *Matthew Hodges*,[14] where the commissioner concluded that the taxpayer had suppressed £4 million in sales made by his one-man scaffolding business. Regardless of this implausibility, the tribunal reduced the amount of the assessment rather than set it aside for invalidity. Accordingly, the authors are of the view that taxpayers stand a better chance of having the amount in a best judgment assessment reduced than the assessment set aside on the basis that it was arbitrarily or erroneously raised.

At first glance, the best judgment assessment provision may appear to grant wide-reaching powers to the DGC. However, there are sufficient checks and balances to ensure that the provision is not abused. First, if the taxpayer can establish that the DGC acted in bad faith or capriciously in raising the best judgment assessment, then the entire assessment can be set aside on the basis that the DGC failed to exercise his best judgment. Second, if there is no such element present but the taxpayer can establish that the amount of tax demanded through the best judgment assessment is incorrect because the DGC failed to consider the material information provided, or that the taxpayer had failed to provide such information during the course of the tax audit, then the taxpayer may move the tribunal to make the necessary adjustment to ensure that he pays the correct amount of tax.

The authors would like to stress that taxpayers must maintain a high standard of record keeping, ensure that GST returns are filed promptly and correctly, and provide all necessary documents and information to Customs during the course of a tax audit. In circumstances where taxpayers are doubtful of their GST treatment or interpretation of the law, they should take proper professional advice, be it from a reputable GST agent or a tax lawyer. **LH-AG**

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14 [2015] UKFTT 227 (TC)