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ABOUT THE AUTHORS

Dato' Nitin Nadkarni
Senior Partner
Tax, Customs & Trade
E: nn@lh-ag.com

Jason Tan Jia Xin
Partner
Tax, Customs & Trade
E: tjx@lh-ag.com

Ivy Ling Yieng Ping
Senior Associate
Tax, Customs & Trade
E: il@lh-ag.com

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***TRSB v KPHDN*: Duty to Give Reason for Imposition of Penalty under Income Tax Act 1967**

In *TRSB v KPHDN*, the High Court recently allowed an appeal by the taxpayer and quashed the penalties imposed by the Director General of Inland Revenue (**DGIR**) pursuant to s 112(3) of the Income Tax Act 1967 (**ITA**). The decision of the High Court is a timely reminder that:

(a) the DGIR must give reasons to taxpayers when he exercises his discretionary powers under the ITA. The DGIR "…*is given a discretion …. he cannot exercise at whim or fancy but after due consideration of all relevant facts and circumstances*";[1]
(b) the court will not hesitate to protect taxpayers and set aside any unjustifiable or excessive penalties imposed by the DGIR under the ITA without a sustainable legal justification.

Readers are reminded of the decisions in *Classic Japan*[2] (see LHAG Insights dated 10 February 2021) and *Club Twenty-One Retail (Malaysia) Sdn Bhd v KPK* (see LHAG Insights dated 11 May 2021), which likewise reiterated the duty of revenue gathering authorities to give reasons for the exercise of discretions.

Brief facts

The taxpayer in *TRSB* filed its tax returns for the years of assessment (**YA**s) 2011 and 2012 based on its management accounts (**Original Returns**). More than a year later, the

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1 *Ketua Pengarah Hasil Dalam Negeri v Kim Thye & Co* [1992] 2 MLJ 708
2 *KPHDN v Classic Japan (M) Sdn Bhd* [2021] 9 MLJ 870

taxpayer amended its Original Returns to reflect the profits shown in its audited accounts (**Revised Returns**). The net effect was that there had been a substantial overpayment of taxes for YA 2012, which exceeded the underpayment of taxes for YA 2011.

Instead of refunding the overpaid taxes for YA 2012, and imposing a penalty under **s 113(2)** of the ITA for underpaid taxes for YA 2011, the DGIR:

(a) disregarded the Original Returns filed by the taxpayer and treated them as a nullity — as if these returns were never filed; and
(b) imposed late submission penalties on the entire tax payable for both YAs 2011 and 2012 pursuant to **s 112(3)** of the ITA, and not just on the shortfall in taxes actually paid for YA 2011.

However, no reason was given for the imposition of penalties on taxes that had already been declared and paid.

It is commonly understood that:

(a) s 112(3) penalises taxpayers who fail to file their tax returns using the prescribed form or within the prescribed time; and
(b) s 113(2) penalises taxpayers who underpay taxes.

It appeared that the DGIR had invoked s 112(3) rather than s 113(2) in order to impose penalties on the entire amount of taxes payable for a year of assessment and not just on the shortfall in taxes paid.

Aggrieved by the excessive penalties imposed, the appellant filed an appeal to the Special Commissioners of Income Tax (**SCIT**). By a Deciding Order dated 18 May 2018, the SCIT agreed with the DGIR and dismissed the taxpayer's appeal.

Appeal to the High Court

The taxpayer appealed to the High Court on the following grounds:

Failure to give any reason

(a) The power to impose penalties under the ITA is a discretionary provision given the use of the word "may" in s 112(3), which is the same as s 113(2) of the ITA. In exercising such discretionary power, the DGIR has a legal duty to give reason,[3] given that:

[3] *Perbadanan Pengurusan Trellises & Ors v Datuk Bandar Kuala Lumpur & Ors* [2021] 2 CLJ 808 and *Uniqlo (Malaysia) Sdn Bhd v Ketua Pengarah Kastam dan Eksais* [2020] 9 CLJ 521

(i) for YA 2012 — the appellant had overstated and overpaid a substantial amount of taxes; and

(ii) for YA 2011 — the DGIR's penalties were not only imposed on the shortfall in taxes, but also on the entire amount of taxes payable for the YA.

The DGIR, as is usual in penalty cases, argued that he had no legal duty to provide a reason for his decision, citing the Federal Court's decision in *Alcatel-Lucent*.[4]

The taxpayer contended that the DGIR did not have an unfettered discretion and could not act arbitrarily "at his whim and fancy", citing the older Supreme Court decision in *Kim Thye*.[5] Further, the reason for the exercise of the discretion should be recorded at the time the decision was made, and not years later during the hearing, citing the Court of Appeal's decisions in *Perbadanan Pengurusan Trellises*[6] and *Uniqlo (Malaysia)*.[7]

No breach of subsection 77A(1)

(b) Penalties, whether imposed under s 112(3) or s 113(2), are premised upon proof of the commission, by the taxpayer, of a predicate criminal offence which the DGIR has chosen not to prosecute. They are therefore penal provisions and should be interpreted strictly with no scope for any meaning by way of extension (*Liew Sai Wah*).[8]

(c) The DGIR argued that the taxpayer breached s 77B by delaying in filing the Revised Returns and breached subsection 77A(3)(b) by not filing tax returns based on the audited account. However, s 112 does not penalise any breach of subsection 77A(3) or s 77B. It is clear that s 112 only penalises default in "*furnishing a return in accordance with* ***subsection…. 77A(1)***". In any event, breach of s 77A(3)(b) is specifically penalised under s 120(1)(h), which only came into force from 31 December 2015.

(d) Subsection 77A(1) of the ITA only requires a taxpayer to file tax returns using the prescribed form and furnish it within the prescribed time. It does not require the taxpayer **to file an accurate tax return or file a tax return using an audited account**.

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4 *Ketua Pengarah Hasil Dalam Negeri v Alcatel-Lucent Malaysia Sdn Bhd & Anor* [2017] 2 CLJ 1

5 *Supra*, n 1

6 *Supra*, n 3

7 *Supra*, n 3

8 *Liew Sai Wah v PP*[1968] 2 MLJ 1

(e) Incorrect returns should be penalised under s 113(2) of the ITA, which only allows for penalties to be imposed on underpaid taxes.

(f) Accordingly, no penalty should have been imposed on YA 2012. As for YA 2011, the penalty should only have been imposed under s 113(2) on the underpaid taxes.

High Court allowed taxpayer's appeal

The High Court held in favour of the taxpayer and set aside the SCIT's Deciding Order and the entire assessment raised by the DGIR. It also ordered that all the penalties paid be refunded to the taxpayer.

Though the matter is currently pending written grounds from the High Court, this decision is important to taxpayers as it highlights that:

(a) The DGIR must give reasons when imposing a penalty. During submissions, the High Court expressed its concern over the absence of reasons for the imposition of penalties on taxes that had already been paid and declared by the taxpayer;

(b) The DGIR is not at liberty to disregard/nullify a tax return that is validly filed by the taxpayer purely on the ground that the return is inaccurate; and

(c) the court will not hesitate to set aside any unjustifiable or excessive penalty imposed by the DGIR.

The taxpayer was successfully represented in this appeal by Dato' Nitin Nadkarni and Ivy Ling Yieng Ping from the firm's Tax, Customs & Trade Practice.

Ivy Ling Yieng Ping (il@lh-ag.com)

If you have any queries, please contact the author or team partners, **Dato' Nitin Nadkarni** and **Jason Tan Jia Xin**, at **tax@lh-ag.com**

LH AG ADVOCATES AND SOLICITORS

Head Office
Level 6, Menara 1 Dutamas
Solaris Dutamas
No. 1, Jalan Dutamas 1
50480 Kuala Lumpur
Malaysia
Tel: +603 6208 5888
Fax: + 603 6201 0122

Johor Office
Suite 21.01
21st Floor, Public Bank Tower
No.19, Jalan Wong Ah Fook
80000 Johor Bahru, Johor
Tel: +607 278 3833
Fax: +607 278 2833

Penang Office
18-33-A3 Gurney Tower
Persiaran Gurney
10250 Georgetown
Pulau Pinang

Email
enquiry@lh-ag.com

Website
www.lh-ag.com

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