An anatomy on incorrect return penalty law equity essay

Law

Inland Revenue's Power in Tax AuditDr. Choong Kwai Fatt1, Advocate & Solicitor, High Court of MalayaIntroductionSince the inception of self-assessment for companies in year of assessment (YA) 2001, incorrect return penalty seems to be the shadow of tax audit. Upon completion of an audit on taxpayers' premises, the Inland Revenue Board (IRB) will impose a penalty ranging from 45% to 100% in addition with the tax undercharged when an additional assessment (Form JA) is issued in relation to that YA. The IRB contended that the taxpayer has submitted an incorrect return resulting income has been understated. Thus s 113(2) of the Income Tax Act 1967 (the Act) was invoked to imposed such a penalty. The taxpayer in many occasions has challenged the validity of such imposition of penalty through tax appeal to the Special Commissioners, the High Court and to Court of Appeal. This article critically analyses the legislation, the recent Special Commissioners', High Courts' and Court of Appeals' case precedents on incorrect return to explore the validity of such penalty and IRB's power in relation to tax audit. The LegislationThe Act requires taxpayer to file a correct return for an accurate tax to be paid as their obligation to the country. Section 113 of the Act is on incorrect return. It sets up the scope of incorrect return being:(a) omitting or understating any income in the tax return; or(b) gives any incorrect information in relation to his own chargeability to tax. Failure to submit a correct return would attract penalty, fine in addition to the tax undercharged or tax omitted. Section 113(1) provides: Any person who-(a) makes an incorrect return by omitting or understating any income of which he is required by this Act to make a return or on behalf of himself or another person; or(b) gives any incorrect

information in relation to any matter affecting his own chargeability to tax or the chargeability to tax of any other person, shall, unless he satisfies the court that the incorrect return or incorrect information was made or given in good faith, be guilty of an offence and shall, on conviction, be liable to a fine of not less than one thousand ringgit and not more than ten thousand ringgit and shall pay a special penalty of double the amount of tax which has been undercharged in consequence of the incorrect return or incorrect information or which would have been undercharged if the return or information had been accepted as correct. Section 113(1) imposes 2 times of the tax undercharged as penalty if a taxpayer is charged in court and found guilty for this offence. A defence of good faith is provided under s 113(1). Section 113(2) provides: Where a person(a) makes an incorrect return by omitting or understating any income of which he is required by this Act to make a return on behalf of himself or another person; or(b) gives any incorrect information in relation to any matter affecting his own chargeability to tax or the chargeability to tax of any other person, then, if no prosecution under sub-s (1) has been instituted in respect of the incorrect return or incorrect information, the Director General may require that person to pay a penalty equal to the amount of tax which has been undercharged in consequence of the incorrect return or incorrect information or which would have been undercharged if the return or information had been accepted as correct; and, if that person pays that penalty (or, where the penalty is abated or remitted under sub-s 124(3), so much, if any, of the penalty as has not been abated or remitted), he shall not be liable to be charged on the same facts with an offence under sub-s (1). Section 113(2) would operate where there is no

prosecution made under s 113(1). A close examination of ss 113(1) and 113(2) revealed that both sections are identical on the offence on omitting, understating income or giving incorrect information in relation to tax return submitted. The imposition of penalty in s 113(1) deals with court while s 113(2) empowered the Director General (IRB) to impose such a penalty. The IRB has the discretion to impose or not to impose such penalty as s 113(2) uses the phrase "the Director General may require". The maximum penalty is one time of the tax undercharged. Section 113 offences cover negligence in computing the tax, unintentionally omitting or understating income, misinform, misunderstanding on its obligation on chargeability resulting incorrect information are provided in the tax return, which has resulted a much lower of income tax to be paid to IRB. These are lesser degree of offences as compare to s 114 wilful evasion. Section 113 attracts penalty, fine but not imprisonment. To expedite the collection and mitigate tax litigation in court, s 113(2) empowers the IRB to exercise its discretion to impose penalty in addition to the tax undercharged arising from the incorrect return submitted. Section 113 has two limbs. The first limb s 113(1) covers prosecution in Court and empowers the Court to impose fine and special penalty double the undercharged tax consequential to the incorrect returns or information. Section 113(2) on the other hand empowers the Director General to exercise discretion to impose penalty up to one time of the tax undercharged should the case is not being prosecuted in court under s 113(1). In both cases of s 113(1) or (2), taxpayer is required to pay additional tax on any tax undercharged arising from the incorrect return submitted. Section 113(1) clearly stated that in the event that the taxpayer

can satisfy the Court that such incorrect return or incorrect information was made or given in good faith, then no penalty would be imposed. However, such wording of "good faith" has missed out in s 113(2) and the complete silence of such a wording would arise suspicions whether such a defence of good faith is indeed available or otherwise in s 113(2). The Inland Revenue Counsels are of the opinion that the legislation being what it is, one should employ literal interpretation. Since s 113(1) employs the word "good faith" and miss out in s 113(2), then one cannot import such "good faith" defence into reading of s 113(2). These literal interpretation has gain support in the recent High Court decision of Ketua Pengarah Hasil Dalam Negeri v NV Alliance Sdn Bhd [2011] 10 CLJ 345 where Dato Aziah Ali J held on p 363: I agree with the Appellant (IRB) that "good faith" is not a defence under s 113(2) of the Act. Therefore the penalty imposed by the Director General in the exercise of the discretion conferred by s 113(2) is correct. With greatest respect, the author begs to differ with this view. Section 113(1) and (2) must never read in isolation. It has to be read in a whole with a totality approach. The taxpayer submits its tax return in the self-assessment regime to the IRB bears onerous responsibility on the tax return given the frequent changes in the Act, case laws, public rulings and IRB practices. The court in many instances acknowledges that tax is a statute creature, a legislation is never easy to be understand. Taxpayer must have presumed submitted in good faith with full compliance to the Act unless proven otherwise. Therefore where taxpayer is exposed to an offence of incorrect return, good faith must be given to determine the innocent mind of the taxpayer, the justification to impose penalty bearing in mind that the imposition of penalty is an offence.

Taxpayer must be given opportunity to mitigate such an offence if being charged on an offence of incorrect return. The IRB's Practice and Its PowerUpon completion of tax audit, the IRB would impose a penalty of 45% to 100% on the tax undercharged under s 113(2) should the tax audits personnel are of the opinion that an incorrect return has been filed. Section 113(2) confers discretion on the IRB whether to impose a penalty after considering all relevant facts. Additional assessments (Form JA) would be issued to recoup the tax undercharged and the penalty. The IRB has the control whether to prosecute or not on the taxpayer relying on s 113(1). It is never a decision of taxpayer to be prosecuted or not. If only on prosecution, taxpayer can rely on "good faith" as a defence, it would be unjust to taxpayer since he cannot exercise such option when he is liable for an offence under s 113(2). In any situations whether in Court or with IRB, the taxpayer would naturally adduce evidence to persuade the IRB or the Court that the tax return is submitted in good faith i. e. the taxpayer has no intention to defraud the government and honestly believe that the return submitted does comply with the Act in order to appeal for the waiver or reduction of penalty. In a non-prosecution case, the taxpayer is as of right to appeal to Special Commissioners" (then the High Court, Court of Appeal) on the additional tax and additional penalty, surely the Special Commissioners, the Court would adjudicate whether such an act of taxpayer tantamount to incorrect return, and if does, it would went further to decide whether with the factual matrix of the case justify to impose a penalty. The benchmark to determine imposition of penalty has to be on good faith as the imposition of penalty which is criminal in nature, the "mens rea" must be determined

critically i. e. whether the taxpayer has intentionally defraud the government or honestly believe such act is permitted. This yardstick using "good faith" on its own would point to one and only one conclusion, good faith must be inherent in s 113(2) and be used to determine whether an incorrect return has been committed by the taxpayer. If the contention that good faith is only available in s 113(1) through prosecution, this would encourage more litigation through court and not through negotiation with IRB which is never the intention of any legislation, more so with Income Tax Act. The Parliament enacted s 113(2) is to encourage settlement without litigation in court. Since s 113(2) permits the IRB to impose penalty in lieu of prosecution in s 113(1), it would then naturally allowed the defence of good faith in s 113(1) to be apply mutatis mutantis in s 113(2). In the Supreme Court case of Ketua Pengarah Hasil Dalam Negeri v Kim Thye & Co [1992] 2 MLJ 708, the Court held that this provision of s 113(2) vested the discretion in the IRB, a discretion that cannot be exercised at whim and fancy. The IRB has to consider the merits of each case, taking into facts and circumstances of each case before imposing such penalty. The Supreme Court also firmly rejected the IRB contention that in s 113(2), "good faith" is not a defence for the taxpayer. In Office Park Development Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri [2011] AMTC 253, the High Court held that the construction of s 113(2) is redundant if it is made without the reference to s 113(1). Section 113(2) operates as an alternative provision to s 113(1). Therefore, Alizatul Khair Osman Khairuddin J concluded that IRB has the discretion to impose penalty and penalty on s 113(2) should not be imposed where taxpayer has acted in good faith and make full disclosure of information. The IRB"s

contention that s 113(2) did not provide the defence of good faith is without basis. Ambiguity in the ActThe rule of interpretation of a provision in tax legislation is to produce harmony result as intended by the Parliament. If one to interprets s 113(1) and 113(2) in isolation, one cannot help to think that such interpretation in s 113(2) create injustice, being a criminal offence without allow the pleading of defence of good faith. It produces an absurd result. It is a settled principle that when construing a taxing statue where there is ambiguity, the sole function of the court is to discover the true intention of the Parliament. This is in line with the provisions in s 17A of the Interpretation Act 1948 and 1967. Section 17A provides:�In the interpretation of a provision of an Act, a construction that would promote the purpose or object underlying the Act (whether that purpose or object is expressly stated in the Act or not) shall be preferred to a construction that would not promote that purpose or object.�The court is duty bound to adopt an interpretation that promote the purpose or the object of the statue which does not cause injustice to the taxpayer or absurdity. In summary, s 113(2) thus must be available with �good faith� as defence as found in s 113(1). As the Income Tax Act imposes liability on the taxpayer, the canon of interpretation applies to ambiguity of the legislation is that the ambiguity must be resolved in favour of the taxpayer. Lord President Hope held in Glenrothes Development Corp v IRC [1994] STC 74 at p 80: But if there is an ambiguity, because the phrase in question is capable of two or more alternative meanings, the ambiguity will be resolved in favour of the taxpayer without regard to the question whether it was appropriate for a tax to be imposed. Section 113(2) has the ambiguity whether �good faith� is

available as a defence. The Court when construe a legislation which is ambiguous, must then construed according to the intention in the Act itself. The Parliament always discourages prosecution, a process which cause precious judicial time, cost to IRB and taxpayer. Thus s 113(2) allows Director General to accelerate administration of the Act. Therefore, giving effect to the will of parliament as expressed in the enactments, "good faith" as a defence in s 113(2) produces harmony in interpretation and also consistent with the legislative intention. The Imposition of PenaltyThe imposition of penalty aims to deter non-compliance and to ensure all taxpayer pays its legally due tax to the government. It discourages the submission of incorrect return. Since the object of the tax audit is to encourage voluntary compliance and educate taxpayer, the IRB should invoke s 113 where there is clear evidence an incorrect return being submitted. Likewise when the act of taxpayer involves on interpretation of law, s 113 is inapplicable, more so in the event the taxpayer is based on good faith. The Income Tax Act is never an easy piece of legislation to understand even to lawyers. It involves an appreciation of accounting principles, evolves into various concept of income starting from gross income, adjusted income, statutory income, aggregate income, defined aggregate income, total income to chargeable income. The Court in many instances have differed opinion when asked to pronounce an opinion or giving effect on a particular section. In Ketua Pengarah Hasil Dalam Negeri v NV Alliance Sdn Bhd [2009] AMTC 1, 242, the Special Commissioners held that expenses/ incentive paid to non-employees are promotional expenses and deductible under s 33(1) of the Act. The High Court however overturned

the decision and concurred with the IRB that such an expense is entertainment thus prohibited by s 39(1)(l) of the Act. This case is an example illustrates the difficulty on the interpretation whether cash incentives paid to non-employees are indeed promotional expenses (tax deductible) or entertainment expenses (not tax deductible). The Special Commissioners' and the Court based on the same facts have arrived at different decisions. Therefore, to penalize the taxpayer being file on an incorrect return on this fact is in breach of natural justice more so when the taxpayer has acted in good faith. The computation of tax in any YA involves the facts and the application of the Act on the facts, namely question of facts and questions of law. If the taxpayer has interpreted the sections of the Act on good faith which is later not accepted by the IRB during the tax audit, the adjudication is determined by Special Commissioners and the Court. Such an issue should not be classified as incorrect return. Section 113 has no application. This is to encourage the development of law in this country and also not unduly penalise taxpayer when undertaking bona fide business decisions. The common notable examples on question of law would be the scope of bad debts in s 34(2), promotion expenses, entertainment expenses in s 39(1)(l), sponsorship expenses, royalty expense and the issue of disposing land is capital gain or business income. Upon completion of tax audit at the taxpayer's premises, the IRB would evaluate the evidence and concluded that taxpayer may has its:(a) income understated; or(b) expenses overly claim, i. e. taxpayer is deducting expenses which were not supposed to be deducted; or(c) double deduction of expenses is wrongly claimed. Penalty of 45% to 100% on the additional tax under s 113(2) being incorrect

return is imposed. The taxpayer on the other hand may argue otherwise, contended by evidence that:(a) the profit is not income but instead capital gain;(b) expenses are deductible under s 33(1) and not prohibited by s 39 of the Act;(c) double deduction of expenses are indeed comply with the gazette orders PU(A) issued by the Ministry of Finance. The taxpayer would further argue that since the crux of an appeal is on question of law, an interpretation that is conforming to the Act and thus the return being submitted in good faith. No penalty should be imposed on. An appeal would be filed to Special Commissioners via Form Q. The tax Court include Special Commissioners are there to adjudicate the matter based on the interpretation of the Act. Special Commissioners' DecisionThe Special Commissioners have consistently in its decision, read s 113 as a whole and allowing good faith as a defence when deciding whether the penalty is appropriate in interpreting s 113(2). It is an academic point that s 113 has no application i. e. no penalty to be imposed when the taxpayer succeed in the appeal. Additional tax earlier imposed in the Form JA would be discharged accordingly. In ELMSB v Ketua Pengarah Hasil Dalam Negeri [2009] AMTC 1, 224, the Special Commissioners held that conference (congress expenses) paid to medical doctor with the objective to promote the taxpayer's pharmaceutical products are revenue expense and tax deductible. Penalty on incorrect return is thus a non issue. Admad Zaki b Husin (Chairman of the Special Commissioners) opined on p 1, 241: Finally, we agree with the appellant that this is only academic. If the issue on congress expenses is allowable, there was no incorrect return filed and no penalty should be imposed. The Two Stages TestIn the case when an appeal was dismissed at first instance, IRB is confirmed on its opinion to collect the

additional tax being tax undercharged as stated in the Form JA. The Special Commissioner would then consider based on the factual matrix, whether IRB is correctly to imposed penalty under s 113(2). The Special Commissioners laid down the two stages test namely s 113 is in applicable if an appeal of taxpayer is allowed (taxpayer won the appeal). In case when an appeal is dismissed, the Special Commissioners would assess whether the crux of the issue involve the determination of question of law, interpretation of technical terms and whether good faith has been displaced. If it does then no penalty on incorrect return. In ELM Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri [2009] AMTC 1, 224, the taxpayer which is in the trading of pharmaceutical products claiming congress expenses, sponsorship for doctor attending conference as revenue expense under s 33(1) which was however contended by IRB personnel as submitting an incorrect return in deducting expenses which were not supposed to be deducted. Thus being imposed 60% penalty on the additional tax payable under s 113(2). In rebutting the allegation of incorrect return, the taxpayer submitted that:(a) the IRB had in prior years allowed the expenses leading the taxpayer to continue claim the expenses in fallowing YAs;(b) the IRB was in possession of the facts and circumstances of the payment of congress expenses;(c) information has been provided correctly to the IRB. Therefore in such circumstances, the return cannot be described as an incorrect return. Good faith has been established. Penalty should not be imposed even if the expenses are not deductible as contended by IRB being entertainment expenses. The Special Commissioners agreed in total of the submission of taxpayer that based on the facts and circumstances of the above agreement, the penalty should not be imposed

against the Appellant, even if the appeal is dismissed. Taxpayer is liable to tax undercharged but excludes the incorrect return penalty. Admad Zaki b Husin (Chairman of the Special Commissioners) held on p 1, 240: On the penalty of 60% imposed under s 113 of the Act, which was on the incorrect return, the Appellant submitted that the congress expenses was claimed as a deduction, with a line by line analysis, since such expenses were first incurred, which were always allowed and admitted and confirmed by AW1. The Appellant maintained that the correct information was given to the Respondent. Therefore, the Respondent had allowed such congress expense in prior years, this lead the Appellant to claim the expenses. The respondent submitted that the penalty was imposed on the ground that the Appellant made incorrect returns in deducting certain expenses which were not supposed to be deducted. The Appellant however submitted that the Respondent had in prior years allowed the expenses and furthermore, the Respondent was in possession of the facts and circumstances of the payment of the congress expenses, in such circumstances, the return cannot be described as an incorrect return. We are of the view that based on the facts and circumstances of the case, the penalty should not be imposed against the Appellant. In relation to the penalty on incorrect return, the Special Commissioners in NV Alliance Sdn Bhd held that since the cash incentives are promotional expenses wholly and exclusively incurred in the production of income and not prohibited by s 39(1)(l), the taxpayer thus submitted its return correctly. S 113(2) is inapplicable. Penalty is not an issue. The Special Commissioners however went on to conclude that even these cash incentive expenses are not allowable, the taxpayer nonetheless

exercised its interpretation in good faith, thus penalty under s 113(2) should not be imposed. The Special Commissioners relied on the defence of good faith in s 113(1) to be read in s 113(2) as the Special Commissioners interpret s 113 as a whole. Ahmad Zaki b Husin (Chairman of the Special Commissioners) opined on p 1, 255: Regarding the penalty under s 113(2) of the Act imposed on the Appellant in this case, we are of the opinion that the imposition of that penalty is wrong in law as even assuming that the expenses claimed are not allowable. Based on the facts of this case the claimed was made base on the Appellant's interpretation in good faith. Therefore the penalty shall not be imposed. In SPM Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri [2008-2009] AMTC 1, 188, the Special Commissioners held that franchise fees based on sales was revenue expenditure and not capital expenditure as contended by IRB. In relation to penalty on incorrect return, the Special Commissioners held that penalty should not be imposed under s 113(2) as:(a) There is no evidence to show that the taxpayer has intention to evade tax;(b) The taxpayer has not concealed the deduction of franchise fees;(c) The taxpayer was fully co-operative during the tax audit. Admad Zaki b Husin (Chairman of the Special Commissioners) held on p 1, 198: In regard to the question of penalty imposed by the Respondent, in case our above finding is wrong, there is no evidence to show that the Appellant had the intention to evade tax. The tax computation prepared by the Appellant shows that the Appellant has taken deductions for the franchise fee and there is nothing to suggest that the Appellant has attempted to conceal the deductions. The Appellant was fully cooperative during the tax audit by the Respondent which resulted in the

Notice of Assessment in question. Therefore we found that there is no justification to impose the penalty. With greatest due respect, the reading of s 113(2) together with s 113(1) merely requires the taxpayer to demonstrate good faith to abate the penalty. Good faith is determined by positive act of honest belief, acted bona fide. What is requires is to adduce evidence that it honestly believe the deduction is available based on its best interpretation of the Act. It never requires taxpayer to adduce evidence that it has no intention to evade tax. If the taxpayer has attempted to evade tax, it would be charged under s 114 ﷺwilful evasionﷺ. It is therefore respectfully submitted there is no evidence to show that the taxpayer has intention to evade tax would not tantamount to be a ground to demonstrate good faith. The Mitigation FactorUpon completion of a tax audit, IRB are empowered to impose a penalty of 45% to 100% of tax undercharged under s 113(2) if they are of the opinion that an incorrect return has been submitted by the taxpayer. Since para 13 Sch 5 of the Act states that the onus of proving that an assessment against which an appeal is made is excessive or erroneous shall be on the appellant, which is the taxpayer, then the taxpayer has to adhere one or more of the followings to discharge the burden being submitting an incorrect return:(a) the income tax return was filed in time;(b) the income tax return was submitted in good faith, compliance to the Act;(c) professional tax advice was taken from either the tax consultant, tax lawyer or tax agent on contentious issue before a decision was made;(d) full disclosure of the facts in the audited accounts, tax computations and accounts. The facts and circumstances must be looked into to see to what extend the evidence was declared in the tax computations. The expenses

incurred were clearly and correctly described in the tax return and submitted to IRB.(e) the taxpayer has no intention to mislead the IRB;(f) the taxpayer was fully co-operative during the tax audit. Technical Adjustment as Mitigation FactorThe IRB has acknowledged the contentious issue in interpretation and application of the Act. It has a practice that technical adjustment would not subject to incorrect return penalty. This position has also conceded by the IRB lawyer in numerous appeals before Special Commissioners. It was acknowledged and accepted by IRB in MAA Bhd v Ketua Pengarah Hasil Dalam Negeri [2010] AMTC 1137 that no penalty should be imposed if it was technical adjustment. In this case, it is concerned whether advertisement cost, training cost and also dinner and award cost incurred by an insurance company is tax deductible. The crux of the issue is what constitutes technical adjustment is subjective and judgemental between person. It is not easy in real scenario to take positions and must be considered with care, depending on the merits and circumstances of the case. In general, technical adjustment involves differing interpretation of a particular section of the Act. Seeking opinion from tax specialist is a must in a self-assessment regime as this add probative value that it is a technical issue and a good ground to mitigate incorrect return penalty. Ignorance of the law is of no excuse. In Syarikat Pukin Ladang Kelapa Sawit Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri [2012] 6 MLJ 411, the taxpayer made advanced rental and claimed as deduction under s 33(1)(b) of the Act. Upon tax audit, IRB impose incorrect return penalty being taxpayer understating its income by claiming excessive rental expense which is never permitted by s 33(1)(b). Section 33(1)(b) clearly states that the deductible rental refers to

rent payable in that period, which limits to annual rental. The Special Commissioners allowed the imposition of penalty as on the facts and merits, the taxpayer is held submitted an incorrect return. The High Court concurred with the Special Commissioners and affirmed the Special Commissioners' decision. The penalty imposed on the taxpayer was correct. The Court held that the clear terms of s 33(1)(b) using the phrase 'rent payable for that period' means any annual rental is deducted. Advance rental is not deductible and there exist no technical difficulties or differing interpretation in s 33(1)(b). In short, the High Court does not allow taxpayer to rely on technical term as mitigation factor. Rohana Yusuf J held on p 425: The evidence in this case shows that the Revenue Board became aware of the RM18, 000, 000 claimed as deduction only upon auditing. Not for the auditing the respondent would not be aware that the deductable rental should be lesser instead. The appellant therefore would be paying less tax. The contention by the appellant that it was made in good faith due to the differing interpretation of the law cannot hold because ignorance of law cannot be a defence. In this case, the learned judge also opined that the necessary consultation from tax consultant on a contentious issue is required to ensure correct return is submitted. Rohana Yusuf J opined on p 425: This country is now adopting a self-assessment regime. Thus in line with the present policy where submission of returns are based on self-assessment by taxpayer, a taxpayer must be mindful of his responsibility to submit correct returns and must necessarily do so upon necessary consultation to ensure correct returns are submitted. In Office Park Development Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri [2011] AMTC 253, the High Court

acknowledged in orbiter the used of professional tax agents to prepare and submit tax return as a mitigation factor to avoid incorrect return being submitted. Professional tax agents being tax specialist would interpret the provisions of the Act and would be able to give opinion on technically and contentious of the issues. Imposition of PenaltySection 113 (2) empowered the IRB to impose penalty where the return is submitted incorrectly resulting loss of revenue to the Government. The IRB being the statutory authority must exercise its discretionary power in accordance with the Act and also the rule of natural justice. All relevant facts and circumstances must be considered with its merits. The IRB must establish the taxpayer omitting or understating the income and it is evidenced by the facts admitted before imposing the penalty under s 113(2). In SSU Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri [2008] AMTC 1, 067, the Special Commissioners found that the taxpayer has:(a) discrepancies in rebates and discounts and evidence shown that rebates are not given to the customers;(b) claim provision of discount as tax deductible expenses. This case justify the imposition of penalty on incorrect return as there were evidence of concealment of income, over claiming expenses or negligently not paying the rebates to the customers even after deduction has been obtained. The Special Commissioners thus found that the penalty of 80% on tax undercharged was justifiable and the IRB indeed has basis to exercise the discretion under s 113(2). Ahmad Zaki b Husin held on p 1, 077: In respect of penalty imposed, we have to view whether the Respondent has the right to impose or otherwise. Under s 113(2) of the Act, the Respondent is empower to impose up to 100% penalty (a penalty equal to the amount of tax). This is the discretion of the

Respondent. Whether it is viewed as harsh or not, or whether it need to differentiate between the technical adjustment or on the difference in the opinion is not material. Therefore, we found the Respondent has sufficient basis to impose the penalty at 80% and no reason for us to interfere. In BTN v Ketua Pengarah Hasil Dalam Negeri [2008] AMTC 1, 079 the Special Commissioners held that the taxpayer has understated the income by not reporting bad debts recovered. The taxpayer failed to declare the correct income in the tax computations. Thus the penalty was appropriate. However the special commissioners revise the penalty rate to 50% of tax undercharged as they found that IRB has failed to apply his minds to the facts and circumstances of the case. Admad Zaki b Husin (Chairman of the Special Commissioners) held on p 1, 086: Regarding the penalty under s 113(2) of the Act, we agreed with the Respondent that the penalty was properly imposed because the amount of RM 593, 598 written off claimed as bad debt was recovered after the Respondent conducted a field audit on the Appellant on the 10th and 11th January 2005. It means the Appellant failed to declare the correct income in their tax computation submitted to the Respondent for the Year of Assessment 1999. Since RW1 (the assessor) admitted that he just follow the guideline of the Director General of Inland Revenue on penalty, it means RW 1 did not apply his mind to the facts and circumstances of the case before imposing the 60% penalty. Therefore we are of the opinion that the Respondent failed to use their discretion properly when they imposed the penalty concern. We are of the view that 50% penalty is justified on the facts and circumstances of the case. We therefore allowed the appeal and the penalty shall be reduced to 50% of the tax

payable for the Year of Assessment 1999. Statutory InterpretationWhere a provision of the Act is stated in clear terms and no ambiguity in the words of the section, the Court would hold that the penalty imposed by the IRB on s 113(2) for incorrect return justify. The taxpayer has to adduce evidence to demonstrate otherwise or providing reasons for the misinterpretation of the Act to convince the Court that such penalty should not be imposed. In KV Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri [2010] AMTC1126, the Special Commissioners held that on the interpretation of s 14 of the Income Tax (Amendment) Act 1999 (A1055), the word "disposal" must referred to both disposer and acquirer. The taxpayer contented that it should only cover the disposer only. Section 14 of the Amendment Act 1999 (A1055) provides: Disposal of stock in trade between companies in the same group shall be treated at cost unless it can be proven to the satisfaction of the Director General that the disposal was made in the ordinary course of its trade. The Special Commissioners held that s 14 is cleared and unambiguous, therefore the principle of strict interpretation applies. Admad Zaki b Husin (Chairman of the Special Commissioners) held on p 1, 134"" Therefore, we are of the view that the disposal of stock in trade between companies in the same group refers to both the disposer as well as the acquirer in the transaction. The words between companies clearly refer to both companies ie the company as the disposer and the other company as acquirer."His lordship went on to conclude that since there is no ambiguity in the words of the s 14, and the taxpayer fails to provide reason as to the misinterpretation, the IRB is right to impose penalty under s 113(2) for incorrect return submission. The penalties are justified. The taxpayer appealed to the High Court as to the

correctness of the Special Commissioners in interpretation of s 14 of Amendment Act. In Kenny Vale Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri [2011] AMTC312, the High Court was asked to determine whether the word "disposal" in s 14 of Amendment Act A1099 should include both disposer company and acquirer company. Mohd Zawawi Salleh J held that the Special Commissioners in the circumstances of the case, there is no reason for for the taxpayer to misinterpret s 14 of the Act A1055, thus the penalties imposed are reasonable and within the scope of s 113(2). The DG has act within jurisdiction. The taxpayer being dissatisfied seek the final redress in the Court of Appeal. In Kenny Vale Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri (W-01-521-2010), Abdul Wahab Patail JCA delivered the court of appeal judgement held that it is cleared from the language of s 14 that it is not confined to remedy against the disposer only. It does cover acquirer as well. In relation as to the penalty under s 113(2), the Court of Appeal however held that since this is the first case involving interpretation and application of s 14, thus penalty should not be imposed. This case demonstrates that the Court of Appeal do not classify the failure interpretation of law as to be tantamount to the submission of incorrect return, which is very beneficial to the development of law in Malaysia self assessment system. ConclusionThe object of s 113 is on incorrect return. IRB when carried out the tax audit would impose penalty ranging from 45% to 100% on the tax undercharged under s 113(2) should there found clear evidence that the act of the taxpayer is intentionally or negligently understating its income. However, IRB must exercise its discretion taking into accounts of the facts and merits of each case. However, s 113 is

inapplicable i. e. no penalty should be imposed when the act of taxpayer is on interpretation of law or application of law into the fact as seen in Ketua Pengarah Hasil Dalam Negeri v NV Alliance Sdn Bhd [2009] AMTC 1, 242 bearing in mind that even the Court differs its opinion in interpretation the question of law based on the same fact. To impose a penalty on interpretation of law is an incorrect return never intended by the Parliament and the demarcation whether such an act of taxpayer is incorrect return must be on good faith, which is discharge on the balance of probability.