

AQP v Comptroller of Income Tax [2011] SGHC 229

In the recent case of *AQP v Comptroller of Income Tax*, the Singapore High Court dismissed an appeal made by AQP, a Singapore-incorporated company listed on the SGX Main Board, and held that the loss that AQP had sustained as a result of the acts of a fraudulent director with overriding powers in the company was not deductible under Section 14(1) of the Act. This Tax Alert analyses the decision and the impact that it has on the checks and balances that companies should have over the powers of management and senior level employees.



Facts of the case

- AQP began as a sole proprietorship established by Mr B in 1956. It was later incorporated as a company in Singapore and by 1998, it was listed on the SGX Main Board.
- In 1995, one of Mr B's children, Mr C, entered into a service agreement with AQP to hold office as Managing Director for three years. This agreement was subsequently renewed for a further three years from October 1998. Mr C was also a member of the AQP Board of Directors at all material times.
- In December 1999, Mr C was dismissed from his positions as Director and Managing Director of AQP for misappropriation of the company's funds. He was charged and tried for criminal breach of trust in the District Court and sentenced to imprisonment for a period of nine years.
- During Mr C's trial, it was revealed that Mr C's modus operandi was to make out false purchase orders to AQP's suppliers for the purchase of bearings (the company's stock in

trade), and claim that he had advanced personal funds to AQP for the purchases. Mr C would also make false claims that he had made loans to AQP's customers for their purchases. . Based on such false claims, AQP would reimburse Mr C. During the trial the District Court found that there was total trust reposed in Mr C by virtue of his senior management position in AQP.

- After Mr C's misappropriations came to light, AQP made provisions for doubtful debts of S\$12,410,141 in its statutory accounts for the year ended 31 December 1999. This amount included the loss of S\$12,272,917 (the "Loss") arising from Mr C's misappropriations.
- No deduction claim was made for the Loss for the Year of Assessment 2000 ("YA 2000").
- In 2003, AQP obtained judgment against Mr C for the amount misappropriated but was unable to recover the funds from him. Mr C was subsequently adjudged bankrupt.

- In December 2005, AQP lodged a claim with the Comptroller of Income Tax (the "Comptroller") for the Loss on the basis of an "error or mistake" under Section 93A of the Singapore Income Tax Act (the "Act"). In response, the Comptroller stated that relief could not be granted on the basis that there was no "error or mistake within the meaning of Section 93A".

- AQP then brought the matter before the Income Tax Board of Review (the "Board") and sought an order to direct the Comptroller to grant it relief (under Section 93A of the Act) and allow the Loss as a deduction for YA 2000 (under Section 14(1) of the Act).

The Board's Decision

- The Board applied the test in the English case of *Curtis (HM Inspector of Taxes) v J & G Oldfield, Limited* (1925) 9 TC 319 (the "Curtis Test"), and noted that Mr C was a substantial shareholder and also the Managing Director of AQP. Mr C was "in a position to do exactly what he likes". The Board concluded that the Loss was not deductible and dismissed AQP's appeal.

- The Board also expressed the view that “if the decision was a mistake”, it still constitutes an “error or mistake” for the purposes of relief under the Act.
- AQP brought the matter on appeal before the High Court.

Issues on Appeal

The issues on appeal before the High Court were essentially whether the Loss was deductible, and whether a mistake of law would fall within the scope of Section 93A of the Act.

The High Court’s Decision

- The High Court held that losses incurred by a company as a result of the fraudulent acts of a person who possessed overriding power or control in the company would not be tax-deductible.
- Accordingly, on the basis that Mr C did possess an overriding power or control in AQP and the defalcations were in fact committed in the exercise of such power, the High Court upheld the Board’s decision and dismissed AQP’s appeal, that is, the Loss that was incurred by AQP due to Mr C’s defalcations did not qualify for a deduction.
- With regard to the issue of “Mistake” in Section 93A(1) of the Act, the High Court expressed its agreement with the Board’s view that a mistake in law can constitute an “error or mistake” under the Act. The High Court was also of the view that the scope of “error or mistake” under the Act was not restricted to “ignorance or inadvertence”.

Our Comments

This case highlights the need for firms to provide adequate checks on its employees, particularly those in the

higher echelons who possess immense power and control. The inability of companies to claim deductions on the losses incurred by dishonest directors and shareholders should act as a deterrent against leaving their powers unchecked.

This case is also helpful in clarifying that the scope of Section 93A of the Act is wide enough to encompass mistakes of law. Prior to this judgment, Section 93A could be said to be generally considered to be so narrow in scope as to be restricted only to the (very few) cases of true ignorance and oversight. This narrow scope made this section almost otiose as it is extremely onerous to prove particularly in this day and age where many companies rely on advisors, both in-house and external.

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