

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D11/91

Penalty tax – whether limitation period of one year applies – sections 54 and 82A of the Inland Revenue Ordinance.

Panel: William Turnbull (chairman), John D Mackie and Nigel A Rigg.

Date of hearing: 6 March 1991.

Date of decision: 13 May 1991.

The Deputy Commissioner exercised the powers given to him under section 82A of the Inland Revenue Ordinance by imposing certain penalties upon the personal representative of a deceased taxpayer in respect of the failure by the taxpayer during his lifetime to file correct profits tax returns. At the hearing of the appeal, the personal representative challenged the penalty tax assessments on the ground that they had been issued more than twelve months after the filing of an estate duty affidavit and were contrary to the provisions of section 54 of the Inland Revenue Ordinance. The Commissioner argued that section 54 of the Inland Revenue Ordinance did not apply to section 82A or to additional tax as provided for in section 82A of the Inland Revenue Ordinance.

Held:

The additional tax assessments were not valid and should be annulled because section 54 of the Inland Revenue Ordinance applies to assessments made under section 82A.

Appeal allowed.

[Editor's note: The Commissioner of Inland Revenue has filed an appeal against this decision.]

Anthony Wu for the Commissioner of Inland Revenue.

Fred Lee of Messrs Lee & Chow for the taxpayer.

Decision:

This is an appeal by the personal representative ('the Taxpayer') of the estate of a deceased person against certain penalty assessments imposed under section 82A of the

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Inland Revenue Ordinance. The facts were not disputed and can be very simply and shortly stated as follows:

1. The deceased died in February 1989. During his lifetime he was the sole proprietor of a business which ceased upon his death.
2. On 28 June 1989 the Taxpayer filed an affidavit as required by the Estate Duty Ordinance.
3. On 6 June 1990 the Taxpayer attended an interview with the investigation officers of the Inland Revenue Department. During the interview the Taxpayer was informed that the affairs of the deceased were under investigation. He was advised of the penalty provisions contained in the Inland Revenue Ordinance. The Taxpayer confirmed that the business had been managed and controlled by the deceased and no books or records had been kept.
4. On 11 June 1990 the assessor discussed the case with the Taxpayer by telephone and proposed that the total discrepancies for the years of assessment 1984/85 to 1988/89 inclusive be agreed at \$900,000. On 15 June 1990 the Taxpayer met the investigation officers again and indicated his acceptance of the total discrepancies of \$900,000 as suggested. On 22 June 1990 a number of additional assessments were issued for the years of assessment 1984/85 to 1988/89 inclusive in the total additional assessable profits of \$900,000.
5. The Deputy Commissioner of Inland Revenue was of the opinion that the deceased and the Taxpayer as personal representative of the estate of the deceased had without reasonable excuse made incorrect profits tax returns in respect of the business of the deceased for the years of assessment 1984/85 to 1987/88 inclusive and 1988/89 respectively. On 10 September 1990 he gave notice to the Taxpayer under section 82A(4) of the Inland Revenue Ordinance that he proposed to assess the Taxpayer to additional tax by way of penalty in respect of the years of assessment 1984/85 to 1988/89.
6. The Taxpayer made submissions to the Deputy Commissioner and on 18 October 1990 the Deputy Commissioner issued notice of assessment and demand for additional tax under section 82A of the Inland Revenue Ordinance for the years of assessment 1984/85 to 1988/89 inclusive as follows:

<u>Year of Assessment</u>	<u>Amount of Additional Tax</u>
	\$
1984/85	12,300
1985/86	11,200
1986/87	7,700
1987/88	5,500
1988/89	<u>1,600</u>

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38,300

At the hearing of the appeal the Taxpayer was represented by his tax representative who informed the Board that there was no dispute with regard to the facts. He said that the appeal was based upon a very narrow point of law. He said that the liability of an executor of a deceased person for the payment of tax under the Inland Revenue Ordinance was clearly set out in section 54 of the Inland Revenue Ordinance. He said that under this section it was quite clear that no assessment or additional assessment shall be made after the expiry of one year from the date of the filing of the estate duty affidavit by the Taxpayer. He pointed out that in the present case the estate duty affidavit had been filed on 28 June 1989. The assessments under section 82A had not been made until 18 October 1990 which was outside of the time limit specified by section 54 and accordingly the penalty assessments should be annulled.

Counsel appeared on behalf of the Commissioner and said that section 54 only related to 'tax' which was defined by section 2(1) of the Inland Revenue Ordinance as excluding additional tax. Accordingly reference in section 54 to 'tax' did not include additional tax. Penalties imposed under section 82A are called additional tax and are not governed by the provisions of section 54.

The point for decision by this Board is a very interesting point which apparently has not arisen previously. It would appear that the practice of the Commissioner and his Deputy has been to assume that the time limit of section 54 does not apply to section 82A penalties. Presumably penalties have been imposed in the past and have not been challenged. However on this we have no evidence or information. It is also immaterial because the previous practice of the Commissioner and his Deputy neither strengthens nor weakens his case.

Section 54 of the Inland Revenue Ordinance reads as follows:

‘ 54. Liability of executor of deceased taxpayer

The executor of a deceased person shall be chargeable with the tax for all periods prior to the date of such person's death with which the said person would be chargeable if he were alive, and shall be liable to do all such acts, matters or things as the deceased person if he were alive would be liable to do under this Ordinance:

Provided that –

- (a) no proceedings, other than an assessment to additional tax under section 82A, shall be instituted against the executor under the provisions of part XIV in respect of any act or default of the deceased person;

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- (b) no assessment or additional assessment in respect of a period prior to the date of such person's death shall be made after the expiry of one year from such date if death, or one year from the date of filing any affidavit required under the Estate Duty Ordinance (Cap 111), whichever is the later.'

If this section is taken in isolation then it would be crystal clear that there is a time limit of one year on any tax liability of a personal representative. Executor is defined as including all personal representatives.

The Commissioner's representative submitted that the entire section is governed by the word 'tax' which appears at the commencement of the section. He said that the entire section can only apply to tax as defined in the Ordinance and 'tax' is clearly defined as excluding 'additional tax'. 'Additional tax', though not defined in the Ordinance refers only to additional tax under section 82A. He said that this is the only reference in the Ordinance to additional tax and the words 'additional tax' are synonymous with 'tax' imposed under section 82A. He then drew our attention to sub-section 6 of section 82A which reads as follows:

- '82A(6) Where a person who is liable to be assessed to additional tax has died, an assessment to additional tax may be made on his executor, and the additional tax shall be recovered as a debt due from and payable out of the deceased person's estate.'

Both the submission made on behalf of the Taxpayer and the submission made on behalf of the Commissioner have substantial logic. Clearly they cannot both be correct and it is necessary for us to interpret the Inland Revenue Ordinance one way or the other.

We start with the clear wording of section 54. With due respect to Counsel for the Commissioner we cannot agree that the word 'tax' which appears at the commencement of the section can be used to limit the meaning of the other words in the section. If this were to be the case then proviso (b) would not read 'assessment or additional assessment' but would read 'assessment or additional assessment to tax'. We note that proviso (a) refers specifically to 'an assessment to additional tax under section 82A'. If section 54 had no application whatsoever to additional tax because it was governed by the restricted meaning of the word 'tax' then proviso (a) would be out of place. The fact that proviso (a) appears in section 54 makes it quite clear that section 54 is related to section 82A additional tax as well as to other 'tax'. Proviso (a) clearly makes reference to 'assessment to additional tax'. Proviso (b) clearly makes reference to 'assessment or additional assessment' without any limitation. If it were the intention of the legislature that proviso (b) should be limited then the wording that one would expect to see would be 'assessment or additional assessment other than an assessment to additional tax'.

We now turn to the wording section 82A. Sub-section 6 which we have quoted above states that an assessment to additional tax may be made on the executor. It does not make any reference to any time limit. However it is not necessary that it should make any

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reference to any time limit because section 54 is the section which contains a clear and unequivocal time limit, namely, that no assessment shall be made on the executor after one year. Accordingly we are of the opinion that the meaning and intent of section 82A is supported by the interpretation which we are giving to section 54.

Because of the past unchallenged practice of the Commissioner and his Deputy and the submission made by Counsel that the intention of the legal draftsman was that the word 'tax' in section 54 should be given a technical meaning governing the entire section and that the exclusion of additional tax from the definition of 'tax' was specifically to ensure that the Commissioner and his Deputy would not be bound by any time limitation. We have also looked at the intent behind section 54. This clearly supports the Taxpayer's interpretation and not that of Counsel for the Commissioner. Where a person dies it is important that the estate should be distributed as quickly as possible. Upon death the assets of a deceased are frozen because of taxation matters. There is an obligation upon the executor to file an estate duty affidavit as quickly as possible. This is something within the power of the executor. Once the executor has filed the estate duty affidavit the Inland Revenue Ordinance imposes a time limit on the Commissioner of one year within which to finalise the tax affairs of the deceased. It would be clearly unwise in many if not most cases for an executor to distribute the assets of a deceased when there is an unknown liability to tax. The period of one year is the period which the legislature considers to be reasonable to protect the interests of the executor and beneficiaries on the one hand and the public revenue on the other hand.

If we were to accept the submission made by Counsel for the Commissioner the result would be that the apparent intention of the second proviso to section 54 would be largely negated. The reason for our stating this is because no executor would know whether or not he would be liable to be assessed under section 82A. In many cases no executor could know with any certainty whether or not the deceased had fulfilled his obligations under the Inland Revenue Ordinance during his lifetime. Accordingly in many cases the estate of a deceased would be frozen for many years with substantial hardship to the beneficiaries. We cannot believe that it was the intention of the legislature to impose a time limit upon the Commissioner in respect of something which can be quantified with reasonable certainty and at the same time leave a large discretionary potential liability with no time limit. This reaffirms the view which we have taken which is that the second proviso to section 54 is a clear limitation stating that no assessment or additional assessment shall be made after one year from the date of the filing of any affidavit. In this case the Deputy Commissioner had issued a number of assessments outside of the one year time limit. For the reasons which we have given the assessments issued under section 82A should be annulled and under the powers given to us by section 68(8) of the Inland Revenue Ordinance we order that all of the penalty tax assessments made under section 82A of the Inland Revenue Ordinance upon the Taxpayer in this case and which are the subject matter of this appeal be annulled.