Case No. D13/04

Penalty tax – validity of compromise – the doctrines of non est factum and duress – appellant about to leave Hong Kong – sections 82A(1)(a) and 82A(4A) of the Inland Revenue Ordinance ('IRO').

Panel: Ronny Wong Fook Hum SC (chairman), Chow Wai Shun and Mary Teresa Wong Tak Lan.

Dates of hearing: 27 September and 9 October 2003 and 8, 10, 12, 13 January and 6 February 2004.
Date of decision: 20 May 2004.

The appellant commenced a sole proprietorship business in the name of Company B. When submitting his return for 1994/95, the appellant informed the Revenue that the business of Company B ceased on 30 March 1995.

The appellant and his former wife were directors of Company F which was incorporated in Hong Kong. On 1 August 1997, the appellant and his former wife commenced a partnership business in the name of Company I which was set up as the trading arm of Company F for the receipt of sale orders.

Following investigation into the affairs of Company F, the Revenue issued a notice of additional assessment against Company F for the year of assessment 1995/96 with additional assessable profits at $2,300,000. The Revenue also issued a notice of assessment against the appellant in respect of Company B for the year of assessment 1995/96 with assessable profits at $600,000. Accounting Firm J, then acting for Company F and the appellant, objected against those assessments.

After the appellant attended three interviews with the Revenue, the latter issued notices of assessment for the year of assessment 1996/97 against Company B with assessable profits at $2,700,000 and against Company F with assessable profits at $2,495,386. Accounting Firm J lodged an objection against those assessments.

On 12 February 2003 the appellant attended a fourth interview with the Revenue. Officers of the Revenue produced two draft compromise agreements in relation to Company F and Company I. The appellant was not prepared to sign the two drafts. Whilst he had no objection to the amount of assessable profits as shown in the drafts, he was not prepared to append his signature

to the two drafts as he did not know what penalty would be imposed by the Commissioner. Upon the request of Mr K and Mr L of Accounting Firm J, the meeting was adjourned for 10 minutes. At the resumption of the meeting, the appellant indicated that he was prepared to sign the drafts. He did so and his signatures were witnessed by Mr L.

On 15 April 2003, the Revenue issued various notices of assessment on the basis of the compromises. There was no objection from the appellant against any of those assessments. On 16 May 2003, pursuant to sections 82A(1)(a) and 82A(4A) of the IRO, the Deputy Commissioner issued various notices of assessment for additional tax by way of penalty against the appellant as the director of Company F and the precedent partner of Company I. The appellant appealed against the additional tax so imposed.

The appellant contended that

a) he attended school up to Primary 6. He has little command of the English language. The Revenue produced a lot of documents at the meeting and he had difficulties following those materials;

b) when the draft compromise agreements in relation to Company F and Company I were produced, he was struck by the figure of $7,756,643 said to be the short returned profit of Company F. He requested Miss Tse of the Revenue for a two day adjournment in order to consider the draft compromises but was refused by the Revenue;

c) during the 10 minutes' adjournment he was advised by Accounting Firm J that he had two alternatives. He felt that the consequence might be very serious should he refuse to sign the compromises. He signed in order to resolve the matter; and

d) he returned to Hong Kong to assist the investigation. He had to leave in May 2003 as his air ticket was only valid for six months. Section 82A(4A) was only applicable to a taxpayer who absconds with the intention of evading his fiscal responsibility.

Held:

1. The crux of the appellant's case is that he did not understand and his request for a two day adjournment was denied. The Board is of the view that these pleas must be analysed in the context of the doctrines of non est factum and duress. There is little doubt that the appellant understood that one of the functions of the compromises was to serve as admission of the amount of assessable profits. He said he was struck by the figure of $7,756,643 said to be the revised assessable profits of Company F. Despite his reservations, he made no challenge against that part of the

Compromises. He therefore had no misapprehension as to the class of document that he was signing. On this ground alone, the doctrine of non est factum has no application.

2. The Board turns to the doctrine of duress. There is nothing improper in the explanations of the penalty provisions given by the Revenue officers. They are indeed duty bound to do so. The appellant did not identify any threat by any officers of the Revenue. His sole complaint was that Miss Tse refused to accede to his request for a two day adjournment. Officers of the Revenue could legitimately take the view that a short adjournment would be sufficient for such purposes. The appellant was then advised by Accounting Firm J. At no time did he seek the advice of Mr K of Accounting Firm J with the view of rescinding the compromises. In these circumstances, the Board is of the view that the compromises are binding. The Board is not entitled to go behind the compromises to re-compute the amount of assessable profits.

3. The power to impose additional tax under section 82A(4A) arises if the Commissioner or a deputy commissioner 'is of the opinion that the person he proposes to assess to additional tax under subsection (1) is about to leave Hong Kong'. The appellant expressly told Miss Tse that he was returning to Country D in May 2003. There is little doubt that he was a person who was about to leave Hong Kong. The Deputy Commissioner was therefore fully entitled to invoke section 82A(4A) in these circumstances. That section does not impose an additional requirement that the Commissioner or her deputy must, in addition, be satisfied that the departure is for the purpose of evading tax.

4. The Board does not know what starting point the Deputy Commissioner adopted in arriving at his assessment. The Board was informed that the Deputy Commissioner had made allowance for the appellant's co-operation. Assuming he made a 30% allowance as suggested by D50/01, that would make his starting point for Company F at 156% and that for Company I at 140%. The Board is of the view that those starting points would be too harsh on the facts of this case. The Board is of the view that the appropriate starting point is 120% of the tax undercharged. For these reasons, the Board would allow the appeal in part and reduce the additional tax assessed to 90% of the tax undercharged for each of the relevant years of assessment in relation to both Company F and Company I.

Appeal allowed in part.

Cases referred to:

Ng Kuen Wai trading as Willie Textiles v Deloitte Touche Tohmatsu 5 HKTC 211
Gallie v Lee [1971] AC 1004
Muskham Finance Ltd v Howard [1963] 1 QB 904
D118/02, IRBRD, vol 18, 90
D53/88, IRBRD, vol 4, 10
D50/01, IRBRD, vol 16, 444

Ip Chui Wue Yun for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

Background

1. Mr A commenced a sole proprietorship business in the name of Company B in 1989. When submitting his return for 1994/95, Mr A informed the Revenue that the business of Company B ceased on 30 March 1995.

2. Despite cessation of its business on 30 March 1995, there were substantial deposits of funds into the account of Company B with Bank C.

Year of assessment	1995/96	1996/97	1997/98	1998/99	1999/2000
Cash and cheque deposits (Deducting returned cheques)	About $2,110,000	About $2,820,000	About $761,000	About $590,000	About $270,000
Transfers	About $450,000	About $2,630,000	About $698,000	About $239,000	About $26,000

3. According to Mr A, he emigrated to Country D in 1994. Madam E and their children were also residing in Country D but it is unclear when they left Hong Kong. The divorce between Mr A and Madam E took place in 2002.

4. Company F is a company incorporated in Hong Kong on 12 November 1992. At all material times, Mr A and his former wife Madam E were directors of Company F. Company F carried on a business of manufacturing and trading of buttons. The main office and the factory of Company F were both located in an industrial building in District G. It had another office in District H.

5. Prior to 18 March 2002, Company F submitted the following returns to the Revenue:

Year of assessment	1995/96	1996/97	1997/98	1998/99	1999/2000	2000/01
Date when return submitted	27-6-1998	27-3-1998	9-2-1999	10-12-1999	13-2-2001	19-1-2002
Profit/(Loss) returned	$70,402	($573,861)	($990,616)	($450,900)	($267,590)	($498,210)
Profit assessed/ (Loss allowed)	$188,763	($704,614)	($963,028)	($393,849)	($267,590)	($498,210)

Company F was late in submitting its returns for 1996/97 and 1997/98. The Commissioner imposed penalties of $1,200 and $3,000 in respect of such delays.

6. On 1 August 1997, Mr A and Madam E commenced a partnership business in the name of Company I. Company I was set up as the trading arm of Company F for the receipt of sale orders.

7. Prior to 18 March 2002, Company I submitted the following returns to the Revenue:

Year of assessment	1997/98	2000/01
Date when return submitted	5-5-1999	5-1-2002
Profit/(Loss) returned	$11,879	($53,518)

Company I was late in submitting its 2000/01 return. The Commissioner imposed a penalty of $600 in respect of such delay.

8. There were also substantial deposits into the Bank C account of Company I for the period between 1 April 1998 and 31 March 2000. The deposits for those two years amounted to $1,362,762 and $2,282,528.

9. On 18 March 2002, the Revenue commenced investigation into the affairs of Company F.

10. On 27 March 2002, the Revenue issued a notice of additional assessment against Company F for the year of assessment 1995/96 with additional assessable profits at $2,300,000. The Revenue also issued a notice of assessment against Mr A in respect of Company B for the year of assessment 1995/96 with assessable profits at $600,000. Accounting Firm J was then acting for Company F and Mr A. By letters dated 12 April 2002 and 2 May 2002, Accounting Firm J objected against those assessments.

11. Officers of the Revenue conducted a site visit on 13 May 2002. There were placed before us copies of the English and Chinese versions of the minutes of that meeting. According to those minutes, the Revenue's team was led by Mrs Ip Chui Wue Yun (Senior Assessor) ['Mrs Ip']. She was assisted by Mr Wong Yee Man (Assessor) ['Mr Y M Wong'] and Miss Tse Nga Yee

(Assistant Assessor) ['Miss Tse']. They were received by Mr A in the company of Mr K and Mr L of Accounting Firm J.

12. According to the minutes of this 13 May 2002 meeting:

(a) Mrs Ip explained that the Revenue would be conducting a tax audit on the business of Company F for the year 2000/01. Should irregularities be uncovered in the audit for that year, the Revenue might take the view that similar irregularities occurred in earlier years. She further explained that penal action would be considered should tax be undercharged and the level of penalty would be considered personally by the Commissioner or her deputy.

(b) The parties discussed the nature of Company F, its raw materials, its products and the invoicing of its sales. Mr A informed the officers that Company F had 10 to 13 workers from time to time.

(c) Statements of Company F's and Company B's Bank C accounts for 2000/01 were produced for the officer's consideration. When asked about the transactions in Company B's account, Mr A explained that the deposits into that account were to facilitate the mortgage repayments of his property in District G.

(d) Mr A informed the Revenue that apart from Company F he had no other source of income. In previous years his salary was $10,000 per month. This was reduced to $7,000 in recent years.

(e) Since emigrating to Country D several years ago, he had thought about sourcing customers in that country. He did not however maintain any business overseas.

(f) He disclosed to the Revenue that he had a piece of property in City M of PRC ['Property N']. He purchased that property as it was close to a button retail market. He stopped paying the mortgage instalments in respect of this property in 1996 as the developer failed to obtain the occupation permit.

(g) Mr A was shown the returns of Company F for the years 1995/96 to 2000/01. He confirmed that he signed those returns and they were correct.

(h) The Revenue officers asked Mr A to submit within two weeks various additional documents including the bank statements of Company F and Company B for 1995/96.

(i) This meeting lasted between 10.15 a.m. and 3.30 p.m. with a lunch break between 12.45 p.m. and 2 p.m.

13. By letter dated 6 August 2002, the Revenue pressed Mr A for supply of the statements of Company B for the period from 1 April 1995 and 31 March 1996. These were sent by Accounting Firm J to the Revenue on 16 September 2002.

14. Mr A attended a second interview with the Revenue on 26 September 2002. This second interview took place in the Inland Revenue Department. It commenced at 2.30 p.m. and lasted till 4.45 p.m. Mr A was accompanied by Mr K and Mr L. Mrs Ip, Miss Tse and Mr Ha Hiu Chi (Assessor) ['Mr Ha'] attended on behalf of the Revenue. A Chinese version of the minutes of this meeting was placed before us. According to the minutes of this second interview:

(a) The Revenue had considered the ledger, accounting records and other documents submitted by Mr A since the first meeting. The purpose of the second interview was to question Mr A in relation to various income and expenditure items recorded therein.

(b) Mr L submitted to the Revenue statements of Company I's and Madam E's bank accounts and Company I's ledger.

(c) Mr A was asked whether proceeds of sale by Company F could have been deposited into the account of Company B. Mr A explained that his primary responsibility was in production and he was not familiar with the accounts. His understanding was that the proceeds of Company F's sales could have been deposited into Company B's account but the same were reflected in the accounting entries of Company F. The Revenue requested Mr A to submit the bank book of Company F and Company B for 1995/96. The Revenue warned Mr A that should they find any shortfall for the year 1995/96, they would use the same as the basis for projecting the shortfalls in other tax years.

(d) Mr A was then questioned extensively on various items of expenditure allegedly incurred by Company F.

(e) According to a breakdown prepared by Accounting Firm J a sum of $72,000 was said to have been incurred as subcontracting fees in favour of Company O located in PRC. According to the ledger, three sums of $8,000, $40,000 and $24,000 made up the sum of $72,000. The cheques for these three sums were all dated after the receipts annexed to the voucher for the three sums. According to the cheque stub for the sum of $40,000, the same was for payment of legal costs in City P of PRC. Such litigation costs were probably incurred in connection with the disputes over Property N. When asked about Company O, Mr A failed to give any direct response.

(f) Mr A was asked about the moulding charges incurred by Company F. He was shown a receipt from Company Q. The receipt did not contain any particular and there were alterations on that receipt. Mr A maintained that his dealings with Company Q were genuine and he could request Company Q to provide proof.

(g) Mr A was asked about various sums expended by Company F for 'consumables stores'. These were in respect of purchases of dolls, electric lighters and other decorative items in City P. Mr A explained that he made these purchases and he hand carried them to Country D with the view of expanding Company F's business through the presence of Madam E in that country. The Revenue expressed reservations that Mr A could have hand carried those purchases to Country D. They pointed out that they would disallow these deductions unless Mr A can demonstrate that these purchases were related to the button business of Company F.

(h) Mr A was further questioned about reimbursements made by Company F in his favour. His attention was drawn to two other receipts which contained various alterations of the sums involved. He provided an explanation for an alteration from $50 to $650 but could not account for an alteration from $190 to $4,030.

(i) The Revenue then produced a breakdown of various items of expenditure which they proposed to disallow. Apart from the items referred to above, they were going to disallow various items of expenditure such as travelling expenses and messing which they considered were personal in nature.

(j) Prior to the conclusion of this second interview, Mrs Ip reiterated the stance of the Revenue:

    (i) Given the cessation of Company B's business and the frequency of deposits into its account thereafter, the Revenue was of the view that the deposits were proceeds of sales by Company F.

    (ii) Company I should have taken the initiative and report to the Revenue any profit it made in the relevant years of assessment. The Revenue would be sending returns to Company I for that purpose.

    (iii) Expenditures of Company F which were fictitious or which were personal in nature would be disallowed.

(k) Mr K expressed understanding of the stance of the Revenue and he directed Mr L to make arrangement with Miss Tse for inspection of the relevant receipts.

15. Mr L duly attended the office of the Revenue on 10 October 2002 and inspected the receipts and general ledger for the year 2000/01 previously submitted to the Revenue. Mr L made notes on his observations.

16. On 28 October 2002, Accounting Firm J submitted Company F's and Company B's bank books for the year 1995/96 to the Revenue.

17. On 1 November 2002, the Revenue issued to Company I profits tax returns for the years 1998/99 and 1999/2000 to be submitted by Company I within one month. On 21 November 2002, Accounting Firm J sought extension of time till 31 December 2002. This request was denied by the Revenue on 29 November 2002. On 23 December 2002, Accounting Firm J informed the Revenue that the returns were mislaid. Duplicate returns were issued by the Revenue on the same day.

18. Mr A allegedly returned to Hong Kong from Country D on 27 November 2002. He told us that his return was for the specific purpose of settling his fiscal affairs with the Revenue.

19. Shortly prior to 30 December 2002, Accounting Firm J submitted to the Revenue draft financial statements and profits tax computation of Company I for 1998/99 and 1999/2000.

20. Mr A attended a third interview with the Revenue on 30 December 2002. He was accompanied by Mr K, Mr L and a Miss R who was the accountant of Company F. They were received by Mrs Ip, Mr Y M Wong and Miss Tse of the Revenue. We had available to us the minutes (in English) of this third meeting. According to the minutes:

(a) The meeting lasted between 2.30 p.m. and 4.15 p.m.

(b) Mr K explained to the Revenue the difficulties they encountered in preparing the returns of Company I. He said Mr A had placed considerable reliance on a part-time accounting staff by the name of Mr S. Mr S had with him some of the invoices and he could no longer be traced. Mr L then showed the Revenue the bank book of Company I and his workings for 1999/2000. He explained to the Revenue how he prepared the financial statements of Company I on the basis of the bank book. Officers of the Revenue took copies of Mr L's workings for their further consideration. Mrs Ip reminded Mr A the issue of penalty in addition to any tax undercharged. Mr A was further reminded that a person chargeable to tax for any year of assessment should inform the Commissioner in writing that he was so chargeable no later than four months after the end of the basis period for the year of assessment. Mr A indicated he fully understood the explanations.

(c) The parties then discussed the deposits into the bank account of Company B for the years 1995/96 to 2000/01. Miss Tse produced a summary which she prepared for the year 1995/96. She explained that she had eliminated all interbank transfers. The Revenue officers maintained that the net deposits were sale proceeds of Company F. There was no dissent from any member of Mr A's camp. In relation to withdrawals from Company B's bank account, the Revenue officers pointed out that save for withdrawals for salary payments totalling $205,000, most of the withdrawals were to meet private and domestic expenditure of Mr A and his family.

(d) Officers of the Revenue adverted to various deposits into the bank accounts of Madam E. Those deposits were in respect of 'Sales of scrap materials'. They expressed the view that such proceeds were assessable income of Company F. Mr A agreed to this suggestion.

(e) The parties then discussed the 'promotion expenses' claimed in the year of assessment 2000/01 in respect of the setting up of a sales stall at the Victoria Park Lunar New Year Fair. The Revenue's proposal to apportion the expenses between 1999/2000 and 2000/01 was rejected by Mr A.

(f) Mr L was then asked for his comments as a result of this review on 10 October 2002. Mr M indicated he had no objection to the Revenue's proposed adjustment in relation to the alleged expenses of Company F. The Revenue officers pointed out that on the basis of expenses disallowed for 2000/01, they would project the expenses for the previous years and would 'add back' the expenses not properly incurred. The meeting was adjourned for the Revenue to prepare a schedule of expenses disallowed for all years from 1995/96 to 2000/01. The schedule was explained to Mr A. He was asked to find out whether salary paid to one Mr T was already claimed in the accounts of Company I. Mr K indicated that he would discuss with Mr A whether the projection back was appropriate for the early years.

21. On 7 February 2003, the Revenue issued notices of assessment for the year of assessment 1996/97 against Company B with assessable profits at $2,700,000 and against Company F with assessable profits at $2,495,386. By letters dated 11 and 20 February 2003, Accounting Firm J lodged an objection against those assessments.

22. On 12 February 2003, Mr A attended a fourth interview with the Revenue. He was accompanied by Miss R, Mr K and Mr L. They were received by Mrs Ip, Mr Y M Wong and Miss Tse. We had before us the minutes (in Chinese) of this fourth meeting. According to the minutes:

(a) The meeting lasted between 2.30 p.m. and 7.10 p.m.

(b) Officers of the Revenue indicated that they had reviewed the workings of Accounting Firm J for the financial statement of Company I for 1999/2000 which they furnished during the third meeting and early that morning. They indicated that the workings of Accounting Firm J were disciplined and correct. They produced a revised profit and loss account of Company I for the year ended 31 March 2000. They explained that they had given Company I the benefit of the doubt. The difference between their revised draft and the draft produced by Accounting Firm J was $60,000 attributable to expenditures unconnected with the business. Discussions were then held and agreement reached on the apportionment of the profits between the years 1998/99 and 1999/2000. The Revenue produced a 'Proposed Computation of Discrepancy and Tax Undercharged' in respect of Company I for the years 1998/99 and 1999/2000. This computation was accepted by Mr A's side. The figures were inserted into the returns of Company I for 1998/99 and 1999/2000 which they had in hand and the completed returns were handed over to officers of the Revenue. In response to inquiry from Mr A as to the amount of tax that he would have to pay, the Revenue officers explained to him the computation of his personal liability.

(c) The parties proceeded to consider the position of Company F. Mr L indicated that after his review on 10 October 2002, he had explained to Mr A details of the deductions disallowed. Mr A expressed understanding and agreed to those figures. The discussions then centred on the deposits into Company B's account. Miss Tse explained that she had deducted all relevant transfers from Company F and other sums which appeared not to constitute sale proceeds. Explanation was sought from Mr A in relation to a sum of $20,000 from Mr U on 9 October 1996, a sum of $5,000 from Mr V on 18 February 1997 and a sum of $49,200 from Miss R on 11 March 1997. After hearing explanations from Mr A, these sums were excluded as sale proceeds. The parties then discussed the extent whereby withdrawals from Company B's account could be regarded as proper expenditure of Company F. Officers from the Revenue indicated that $40,000 could be regarded as proper withdrawal for the year 1996/97 but there was no proper withdrawal for the years 1997/98 to 2000/01.

(d) The meeting was adjourned at 5.10 p.m. to enable the Revenue officers to prepare a revised computation for the consideration of Mr A. The meeting resumed at 5.45 p.m. Officers of the Revenue showed the interviewees a proposed computation and explained its contents. After considering its contents, Mr A indicated acceptance of the manner of computation.

(e) Mrs Ip then reminded Mr A the penalty provisions and the power of the Commissioner or her deputy to impose additional tax up to three times of the tax undercharged. Mr A said he understood those provisions and expressed the hope that the Commissioner would adopt a lenient attitude towards his case. He pointed out that the accounts of Company B were handled by his relative Miss W till 2000. Mr S took over and he failed to handle the accounts properly. Mr K also pointed out that Mr A had been co-operative throughout.

(f) Officers of the Revenue then produced two draft compromise agreements in relation to Company F and Company I. The drafts referred to Mr A's acceptance of the assessable profits of Company F for the years 1995/96 to 2000/01 and the assessable profits of Company I for the years 1998/99 and 1999/2000. The total amount of understated profits for Company F and Company I amounted to $7,756,643 and $1,271,575 respectively. Both drafts contained a paragraph indicating that 'acceptance of the above-mentioned assessable profits does not conclude the whole matter and that the case will be put up to the Commissioner or Deputy Commissioner for consideration of penal action...'. The two drafts were worded in English and in Chinese.

(g) Mr A was not prepared to sign the two drafts. Whilst he had no objection to the amount of assessable profits as shown in the drafts, he was not prepared to append his signature to the two drafts as he did not know what penalty would be imposed by the Commissioner or her deputy. Mrs Ip explained to Mr A that the drafts served the dual purpose of recording the compromise on assessable profits and as a reminder to the taxpayer that the matter was not finalised as penalty tax was a matter for the Commissioner or her deputy. The meeting was further adjourned upon the request of Mr K and Mr L.

(h) The meeting resumed about 10 minutes later. Mr A indicated that he was prepared to sign the drafts. He did so and his signatures were witnessed by Mr L. Copies of the signed agreements ['the Compromises(s)'] were provided to Mr A and Mr L.

23. The fiscal position of Company F before and after the Compromise is as follows:

Year of assessment	**Profit/(Loss) previously submitted**	**Assessable profits as a result of the Compromise**	**Assessable profits short returned**	**Tax undercharged**
1995/96	$188,763	$2,422,870	$2,234,207	$368,644
1996/97	($704,614)	$2,327,890	$3,032,504	$384,101
1997/98	($963,028)	$60,739	$1,023,767	$9,019
1998/99	($393,849)	$39,644	$433,493	$6,343

1999/2000	($267,590)	$216,427	$484,017	$34,628
2000/01	($498,210)	$50,445	$548,655	$8,071
	($2,638,528)	$5,118,115	$7,756,643	$810,806

24. The fiscal position of Company I before and after the Compromise is as follows:

Year of assessment	**Profit/(Loss) previously submitted**	**Assessable profits as a result of the Compromise**	**Assessable profits short returned**	**Tax undercharged**
1998/99	Nil	$448,963	$448,963	$36,325
1999/2000	Nil	$822,612	$822,612	$114,998
		$1,271,575	$1,271,575	$151,323

25. By letter dated 15 March 2003, Mr A wrote to the Revenue in relation to the notice of assessment against Company F for 1996/97 referred to in paragraph 21 above. He pointed out that the company had reached agreement with the Revenue pursuant to the field audit and given his financial difficulties he would like to discharge the tax payable by six instalments. The Revenue responded on 17 March 2003 acceding to Mr A's request.

26. By letter dated 19 March 2003, Mr Y M Wong sent to Mr A with copy to Accounting Firm J the minutes of the meeting held on 12 February 2003. Mr A was asked to comment within 30 days. There was no reply to this letter.

27. On 15 April 2003, the Revenue issued various notices of assessment on the basis of the Compromises. There was no objection from Mr A against any of those assessments.

28. Mr A visited the Revenue on 22 April 2003 to discuss the issue of instalment payment. He was received by Miss Tse. He informed Miss Tse that he would be returning to Country D in May 2003.

29. On 16 May 2003, pursuant to sections 82A(1)(a) and 82A(4A) of the Inland Revenue Ordinance ['IRO'], the Deputy Commissioner issued the following notices of assessment for additional tax by way of penalty against Mr A as the director of Company F:

Year of assessment	**Tax undercharged**	**Additional Tax**	**% of Additional Tax to Tax Undercharged**
1995/96	$368,644	$470,000	127%
1996/97	$384,101	$489,000	127%
1997/98	$9,019	$11,000	122%
1998/99	$6,343	$7,000	110%
1999/2000	$34,628	$37,000	107%
2000/01	$8,071	$8,000	99%

	$810,806	$1,022,000	126%

30. On the same day and pursuant to the same provisions, the Deputy Commissioner issued the following notices of assessment for additional tax by way of penalty against Mr A as the Precedent Partner of Company I:

Year of assessment	**Tax undercharged**	**Additional Tax**	**% of Additional Tax to Tax Undercharged**
1998/99	$36,325	$42,000	115%
1999/2000	$114,998	$125,000	109%
	$151,323	$167,000	110%

31. We are concerned with Mr A's appeal against the additional tax so imposed.

The hearing before us

32. Mrs Ip appeared on behalf of the Revenue. At inception of the hearing, we expressed reservations about the wisdom of such course. Mrs Ip participated in most meetings between Mr A and the Revenue. What transpired at those meetings was a live issue before us. Mrs Ip obviously has an interest to uphold the Revenue's case as to what happened at those meetings. Her interest was not reduced by her attempt to confine the oral testimony of the Revenue to that of Mr Y M Wong. Throughout the hearing before us, Mr A made repeated references to Mrs Ip's role. Such references were obviously embarrassing to Mrs Ip in advocating the Revenue's case. In this connection, it is interesting to note Rule 60 in the Code of Conduct of the Bar which provides that a barrister may not appear as Counsel 'in a matter in which he himself is a party or has a significant...interest.' Whilst we recognise that the Code does not extend to officers of the Revenue appearing before this Board, the spirit behind the rule is of some relevance. Given the repeated adjournments of this appeal, it should not have been difficult for the Revenue to find an independent officer to present its case before us.

33. Whilst Mr A appeared in person throughout the appeal, Mr K attended every session until after conclusion of his evidence. We are impressed by his professional attitude.

The evidence before us

34. The following are the salient points of Mr A's sworn testimony before us:

(a) He attended school up to Primary 6. He has little command of the English language.

(b) He was co-operative throughout the investigation. He returned to Hong Kong in May 2002 to meet officers from the Revenue. He made repeated calls to Miss Tse to monitor the progress.

(c) He was asked by this Board to comment on the accuracy of the Chinese version of the minutes of the 13 May 2002 meeting. He gave us a slow and laborious commentary of that minutes. Our overall impression is that he did not have any significant challenge as to what transpired at that meeting.

(d) In relation to the meeting held on 26 September 2002, he accepted that he did respond to questions posed by the Revenue.

(e) He admitted that Accounting Firm J discussed with him the outcome of their inspection on 10 October 2002. He could not recall whether explanations were given to him by Mr K or Mr L. He was told that there were alterations on the receipts and some of the receipts were for meals. He did not comment on Mr L's observations as he did not have sight of the receipts.

(f) He admitted that he was asked whether he had any views on the various deductions at the meeting held on 30 December 2002. He further admitted that he expressed no view. He explained that was because he did not inspect the receipts himself. He also accepted that the Revenue did indicate that the findings for 2000/01 would be used as the basis for projection.

(g) He said the Revenue produced a lot of documents at the meeting held on 12 February 2003 and he had difficulties following those materials.

(h) When the draft compromise agreements in relation to Company F and Company I were produced, he was struck by the figure of $7,756,643 said to be the short returned profit of Company F. Whilst he did make profits in 1995 and 1996, the substantial loss in 1997 wiped out such profits. He requested Miss Tse for a two day adjournment in order to consider the draft Compromises. This was refused by the Revenue. He was however ready to sign the draft Compromises had the Revenue been prepared to delete the paragraph about penalty tax. He was reluctant to accept that paragraph due to its uncertainties.

(i) During the 10 minutes' adjournment, he was advised by Accounting Firm J that he had two alternatives. He could sign or he could refused to sign. Should he refuse to sign, the Revenue would have to repeat the same exercise. This would create a worse impression and would make the matter more serious. He felt that

the consequence might be very serious should he refuse to sign the Compromises. He signed in order to resolve the matter.

(j) He admitted receipt of the English minutes of the 13 May 2002 meeting. His request for a Chinese version of that document was not acceded to. He asked for a copy of the minutes of the 26 September 2002 meeting but his request was refused by Mrs Ip on the basis that the minutes were internal records of the Revenue. He did not comment on the accuracy of the minutes for the 12 February 2003 meeting as he did not have a full set of the previous minutes.

(k) Prior to the commencement of this appeal, he himself conducted a review of the relevant receipts on 3 and 4 September 2003. He sought to re-open various items of expenditure disallowed by the Revenue. We give the following illustrations:

(i) Travelling expenses: He argued that the same should be deductible as he was residing in Country D and was coming back to Hong Kong to look after the affairs of Company F.

(ii) Altered invoices: He agreed that some of the invoices had been altered and the sum involved was $17,240. In relation to an invoice from CD-ROM 98 dated 20 December 2000, he argued that there was nothing unusual in the alteration of the figures $50 to $650 in that invoice.

(iii) Moulds: Save for an invoice for $1,200 which might be a duplicate, he said the rest of the invoices are genuine.

(l) He did not receive any salary from Company F or Company I. All expenses, personal and corporate, came out of the companies. He now appreciates that this modus operandi is inappropriate.

(m) He was distinctly aggrieved by the fact that the penalties were assessed on the basis of section 82A(4A) of the IRO. He argued that section 82A(4A) is only applicable to a taxpayer who absconds with the intention of evading his fiscal responsibility. He said he returned to Hong Kong to assist the investigation. He had to leave in May 2003 as his air ticket was only valid for six months. By invoking section 82A(4A), he was deprived of the opportunity of making representations to the Commissioner.

(n) As far as the level of penalty is concerned, he laid considerable emphasis on his lack of intention to evade tax. He reiterated that he had been co-operative throughout.

35. Mr A invited Mr K to give evidence. According to Mr K:

(a) His firm was the auditor for Company F for the years 1995/96 to 2000/01. In the course of such audits, Mr A told his firm that all relevant materials had been provided for their consideration. His firm was not provided with the bank book or bank statements of Company B.

(b) Prior to the first interview with the Revenue on 13 May 2002, the consensus between his firm and Mr A was to conclude this case as soon as possible with every co-operation being extended to the Revenue. He also explained to Mr A that the onus of proof rested with the taxpayer.

(c) His firm received a copy of the English minutes for the 13 May 2002 meeting. His firm offered to explain that document to Mr A. A brief explanation was indeed given. He confirmed that Mr A did indicate that he wished to have a Chinese version of that and subsequent minutes.

(d) Mr L is a qualified accountant. He reported to Mr A the outcome of his review on 10 October 2002. Mr L observed that the travelling expenses and the expenditures in City M and Country D would appear to be personal expenditures. Mr A was told that there were alterations on various receipts. Mr A said he played no part in such alterations. Their suggestion for a full review for all the years was not taken up by Mr A. Prior to the meeting on 30 December 2002, Mr A made no suggestion that various items of expenditure were properly deductible.

(e) Mr K was questioned on what transpired at the meetings on 26 September 2002 and 30 December 2002. His evidence gave general endorsement to the minutes of these two meetings.

(f) He confirmed that officers of the Revenue did explain the contents of the draft Compromises. Mr A refused to sign as he was unhappy with the passage in relation to penalty. During the 10 minutes' adjournment, he explained to Mr A that they had no right to demand deletion of the passage on penalty from the draft Compromises and his only alternative was to refuse to sign altogether. He then advised Mr A that other factors had to be taken into account should he decide to adopt that course. Mr A eventually signed but with reluctance. At no time thereafter did Mr A express the wish to rescind the Compromises.

(g) He approached Mr A after he received the minutes of the 12 February 2003 meeting. He asked Mr A whether he agreed with its contents. Mr A said there was no need for his firm to be involved and he could handle the matter himself.

(h) He checked the various notices of assessment dated 15 April 2003. He contacted Mr A. Mr A again said he could handle the matter himself.

36. The Revenue called Mr Y M Wong. His evidence is generally confirmatory of the minutes of meetings which he attended. The following additional points are note-worthy:

(a) Cantonese was used at the 30 December 2002 meeting.

(b) At the meeting on 12 February 2003. Mr A commented on the schedule of expenses disallowed for the years between 1995/96 and 2000/01. He indicated that some years were on the high side whilst others were on the low side but he agreed with the overall results.

(c) At no time during the 12 February 2003 meeting did Mr A ask for any adjournment on the basis that he had difficulties following any of the documents produced. He had no recollection of any request made by Mr A for a two day adjournment to consider the draft Compromises.

(d) He joined Miss Tse when Mr A visited the Revenue on 22 April 2003. He denied any intimation by Mr A that his return to Country D was attributable to the deadline of his air ticket. He raised with Mr A the possibility of Mr A executing a personal guarantee in respect of his tax liabilities.

Our assessment of the evidence

37. As we observed above, we are impressed by the professional attitude of Mr K. We reject Mr A's unwarranted insinuation that Mr K tilted his evidence in favour of the Revenue. We accept the evidence of Mr K.

38. Save for one important aspect which we refer to below, Mr A made little challenge as to what transpired at the four meetings. His case in essence is that he did not follow and could not understand what was discussed between the Revenue and his own advisers. We therefore accept (subject to paragraph 40 hereunder) the minutes of the four meetings as accurate record of what transpired between the parties. To the extent that Mr Y M Wong's evidence is confirmatory of the minutes, we accept his evidence.

39. As far as Mr A's alleged ignorance is concerned, we find his performance before this Board of some significance. He adopted a somewhat laid back attitude at the commencement of

the appeal. He did not read the bundles and had little preparation. After repeated promptings by this Board, he was able to address the issues and present an intelligible case. We are of the view that his performance before us is illustrative of his attitude in the course of the investigation. Our impression is that the did not take a personal interest and was content to rely on the professional advice of Accounting Firm J. Had he adopted a more proactive approach, we have no doubt that he would have a much better grasp of the details. This is not to say that he did not appreciate the issues. The meetings centred around the nature of the withdrawals and deposits into the two bank accounts of Company B and Company I and the extent they could be regarded as the profits of Company F and Company I. Whilst Mr A might not have in hand the full details, the extent that he participated at the meetings leads us to conclude that he was sufficiently appraised of the principal issues.

40. The most important conflict between Mr A and the Revenue relates to his contention that he requested for a two day adjournment from Miss Tse for consideration of the draft Compromises. The Revenue did not call Miss Tse to refute this suggestion. Mr A was emphatic in his recollection. We accept his evidence on this point.

The issues before us

41. The first issue is the validity of the Compromises. Mr A is in essence denying any short return of profits. In dealing with this issue, we have not lost sight of the fact that this appeal relates to the additional tax imposed on 16 May 2003 and Mr A made no objection against the assessments of 15 April 2003.

42. The second issue is whether the Deputy Commissioner is correct to impose additional tax under section 82A(4A) of the IRO.

43. The third issue is whether the additional tax imposed is excessive in all the circumstances.

The first issue – validity of the Compromises

44. The Revenue drew our attention to the decision of Recorder Edward Chan S C in Ng Kuen Wai Trading as Willie Textiles v Deloitte Touche Tohmatsu 5 HKTC 211. In that case the taxpayer sued its professional adviser for negligence in respect of their professional advice leading to his conclusion of a compromise with the Revenue as to the amount of assessable profits of his group of companies. The taxpayer also sought a declaration against the Revenue that the compromise was void and of no effect. This claim was struck out by the Learned Recorder. At page 217, the Learned Recorder observed that:

> *' In the present case, it is plain from paragraph 12 of the Amended Statement of Claim that the reason for entering into the agreement with the IRD was that*

the Plaintiff would want to put an end to the investigation by the IRD on the Plaintiff's or his group's liability for under reporting their tax liability in the tax returns of the relevant tax years. It is a binding compromise bona fide entered into by both the Plaintiff and the IRD. There was ample consideration for this compromise and I see no reason for setting aside this contract. It is trite law that once a compromise is reached, it is not open to the party against whom the claim is made to avoid the compromise on the ground that the claim was in fact invalid, provided that the claim was made in good faith and was reasonably believed to be valid by the party contracting it...'

45. We are of the view that Ng Kuen Wai Trading as Willie Textiles v Deloitte Touche Tohmatsu does not provide a complete answer to Mr A's plea. The crux of Mr A's case is that he did not understand and his request for a two day adjournment was denied. We are of the view that these pleas must be analysed in the context of the doctrines of non est factum and duress.

46. The judgment of Lord Pearson in Gallie v Lee [1971] AC 1004 is the leading authority on the doctrine of non est factum:

(a) At page 1033D, his Lordship cited with approval the following dictum of Donovan LJ in Muskham Finance Ltd. v Howard [1963] 1 QB 904 at page 912

'*The plea of non est factum is a plea which must necessarily be kept within narrow limits. Much confusion and uncertainty would result in the field of contract and elsewhere if a man were permitted to try to disown his signature simply by asserting that he did not understand that which he had signed'.*

(b) At page 1034A, his Lordship pointed out that the plea should not be successful in

'*The normal case of a man who, however much he may have been misinformed about the nature of a deed or document, could easily have ascertained its true nature by reading it and has taken upon himself the risk of not reading it'.*

(c) At 1034D, his Lordship stated that:

'*In my opinion, the plea of non est factum ought to be available in a proper case for the relief of a person who for permanent or temporary reasons (not limited to blindness or illiteracy) is not capable of both reading and sufficiently understanding the deed or other document to be*

signed. By "sufficiently understanding" I mean understanding at least to the point of detecting a fundamental difference between the actual document and the document as the signer had believed it to be. There must be a proper case for such relief. There would not be a proper case if (a) the signature of the document was brought about by negligence of the signer in failing to take precautions which he ought to have taken, or (b) the actual document was not fundamentally different from the document as the signer believed it to be'.

47. Applying these principles to the facts of this case, there is little doubt that Mr A understood that one of the functions of the Compromises was to serve as admission of the amount of assessable profits. He said he was struck by the figure of $7,756,643 said to be the revised assessable profits of Company F. Despite his reservations, he made no challenge against that part of the Compromises. His challenge centred round deletion of the paragraph about penalty assessment. He therefore had no misapprehension as to the class of document that he was signing. On this ground alone, the doctrine of non est factum has no application.

48. We turn to the doctrine of duress and we are guided by the following principles stated in Chitty on Contracts General Principles 28th edition

(a) § 7-002 which states that:

'But the basis of the law relating to these topics has been reconsidered in light of the speeches in the House of Lords in Lynch v DPP of Northern Ireland....All five members of the House of Lords in Lynch's case rejected the notion that duress deprives a person of his free choice, or makes his act involuntary. Duress does not "overbear" the will, nor destroy it: it "deflects" it.'

(b) § 7-006 which states that:

'Clearly, not all pressure is illegitimate, nor even are all threats illegitimate...Nor can it even be said that the force or weight of the pressure or the threats is the decisive factor, for in life, including the life of commerce and finance, many acts are done under pressure, sometimes overwhelming pressure, so that one can say that the actor had no choice but to act'.

(c) § 7-012 which states that:

'In determining the validity of the plea of duress in such circumstances, Lord Scarman said that "it is material to inquire whether the person

> *alleged to have been coerced did or did not protest; whether, at the time he was allegedly coerced into making the contract, he did or did not have an alternative course open to him such as an adequate legal remedy; whether he was independently advised; and whether after entering the contract he took steps to avoid it"'.*

49. There is nothing improper in the explanations of the penalty provisions given by the Revenue officers. They are indeed duty bound to do so. Mr A did not identify any threat by any officers of the Revenue. His sole complaint was that Miss Tse refused to accede to his request for a two day adjournment. At that juncture, there was no debate over the amount of assessable profits. His only objection was against the passage on penalty assessment. Officers of the Revenue could legitimately take the view that a short adjournment would be sufficient for such purpose. Mr A was then advised by Accounting Firm J. Mr A did not challenge the advice which Mr K said he gave during the adjournment. Mr K told him that one alternative opened to him was to refuse to sign altogether. He did not adopt that alternative in view of the other factors which Mr K outlined. He made no attempt to disavow the Compromises after the 12 February 2003 meeting. He made express reference to it in his letter to the Revenue dated 15 March 2003. Mr K continued to act for him until the lodging of this appeal. At no time did he seek the advice of Mr K with the view of rescinding the Compromises.

50. In these circumstances, we are of the view that the Compromises are binding. We are not entitled to go behind the Compromises to re-compute the amount of assessable profits. The returns of Company F are incorrect. Mr A failed to submit relevant returns for Company I. There is no reasonable excuse for these omissions.

Whether the Deputy Commissioner is correct to impose additional tax under section 82A(4A) of the IRO

51. The power to impose additional tax under section 82A(4A) arises if the Commissioner or a deputy commissioner 'is of the opinion that the person he proposes to assess to additional tax under subsection (1) is about to leave Hong Kong'.

52. Mr A expressly told Miss Tse on 22 April 2003 that he was returning to Country D in May 2003. There is little doubt that he was a person who was about to leave Hong Kong. The Deputy Commissioner is therefore fully entitled to invoke section 82A(4A) in these circumstances. That section does not impose an additional requirement that the Commissioner or her deputy must, in addition, be satisfied that the departure is for the purpose of evading tax.

Whether the additional tax is excessive in all the circumstances

53. The overall percentage in respect of Company F is 126% of the tax undercharged and in respect of Company I is 110% of the tax undercharged. We have difficulties in justifying the

discrepancy. Whilst it is true that the defaults of Company F consisted of submission of incorrect returns and the omission of Company I was its failure to submit the relevant returns, the reality of the situation is that there was no reporting to the Revenue of the proceeds of sales deposited into their bank accounts. We are therefore of the view that there should be no distinction between the two.

54. In D118/02, IRBRD, vol 18, 90 this Board endorsed the statement in D53/88, IRBRD, vol 4, 10 that penalty at 100% of the amount of tax undercharged is appropriate to those cases:

(a) where there has been no criminal intent and the taxpayer has totally failed in his or its obligations under the IRO or

(b) where the Commissioner has had to resort to investigations or the preparation of assets betterment statements or has otherwise had difficulty in assessing the tax or

(c) where the failure by the taxpayer to fulfill his or its obligations under the IRO has persisted for a number of years.

55. In D50/01, IRBRD, vol 16, 444 at 450 this Board pointed out that:

> *'...every encouragement should be given to taxpayers to settle their differences with the Revenue. Unless the fiscal position of the taxpayer in question is clear beyond doubt so that no weight should be given to his concession, the taxpayer's readiness to bring his dispute with the Revenue to a speedy resolution must be given weight in assessing additional tax levied on the basis of his liability crystallised as a result of the compromise'.*

The Board in that case thought that there should be a 30% deduction from the starting point.

56. In considering the amount of penalty, we are of the view that the following factors are adverse to the position of the Appellants:

(a) No cogent explanation has been given as to why the deposits into the Bank C accounts of Company I and Company B were not reported to the Revenue. Mr K told us that he was not informed of these deposits either. It is no answer to say that the matter was left with Miss R. Mr A himself admitted that the Company F was making profits in 1995 and 1996.

(b) The accounts were supported by altered invoices. Whilst the evidence before us does not suggest that such alterations were wide-spread, it is nonetheless a significant factor to be taken into account.

57. We are of the view that the following factors are in favour of the Appellants:

(a) We accept the evidence of Mr K. From inception, the whole approach of the Appellants was to co-operate with the Revenue.

(b) There was actual co-operation by the Appellants. The submission of documents were generally timely. The draft financial statement of Company I for 1999/2000 produced by Accounting Firm J was found by the Revenue to be disciplined and correct.

(c) We accept Mr A's evidence that he made repeated calls to the Revenue to press for finalisation of his position. The minutes of the four meetings do reflect a genuine spirit of compromise. He eventually backed down on 12 February 2003 with the view of gaining sympathetic treatment for his concessions.

58. We do not know what starting point did the Deputy Commissioner adopt in arriving at his assessment. Mrs Ip informed us that the Deputy Commissioner had made allowance for the Appellant's co-operation. Assuming he made a 30% allowance as suggested by D50/01, that would make his starting point for Company F at 156% and his starting point for Company I at 140%. We are of the view that those starting points would be too harsh on the facts of this case.

59. We have no doubt that Mr A had totally failed in his obligations under the IRO. The defaults continued for a number of years. Some of the invoices were altered. Given these aggravating features, we are of the view that the appropriate starting point is 120% of the tax undercharged. The Revenue acknowledged that there was co-operation. Given the factors which we outlined in paragraph 57 above, we are of the view that the 30% discount is applicable. We have not made any distinction between the years but have taken an overall view of the defaults.

60. For these reasons, we would allow the appeal in part and reduce the additional tax assessed to 90% of the tax undercharged for each of the relevant years of assessment in relation to both Company F and Company I.