INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D133/98

Profits tax – additional tax – procedure of assessing additional tax provided for by statute – instruction of taxing statutes – whether provisions directory or mandatory – whether any prejudice caused by irregularity in procedure – whether no-compliance nullify assessment – sections 82A(3) and 82A(4) of the Inland Revenue Ordinance – service of notice – shifting of burden – section 58(4) of the Inland Revenue Ordinance – rationale of tax undercharged as basis for assessment of additional tax.

Panel: Christopher Chan Cheuk (chairman), Vernon F Moore and Gerald To Hin Tsun.

Dates of hearing: 16 July 1998, 9 and 22 September 1998.
Date of decision: 15 December 1998.

The taxpayer, a company, appeals against the assessments of additional taxes made under section 82A of the Inland Revenue Ordinance (the IRO) for the years of assessment 1994/95 and 1995/96 on the grounds that the balance of tax due was nil, therefore there was no tax undercharged and the taxpayer was not liable to be assessed under section 82A; no notice of intention to assess additional tax was given; and the system was unfair to the taxpayer.

The Board on its own initiative raised a preliminary point that the Revenue had failed to follow the procedure and provisions in the IRO in requiring the person who issued the notice under section 82A(4) and the person who made the assessment for additional tax should be one and the same person. The Board noted that five mandatory chronological steps have been identified in D15/98 to be observed prior to the imposition of additional tax of which steps (b) to (e) should be considered and handled by the same person. The preliminary question for the Board was whether the assessments were valid if steps (b) and (c) (decision to assess additional tax and the issue of notice of such decision) are performed by one person and steps (d) and (e) (the taxpayer's representation and imposition of additional tax) by another.

Held:

Preliminary point

(1) Sections 82A(3) and 82A(4) provide that it should be one person to perform all the four function in steps (b) to (e). Since taxing statutes should be construed strictly (Halsbury's Laws of England, Vol 44, paragraph 912 considered), there is therefore irregularity in the present case in that the steps were carried out by two different persons.

(2) The general intent of the legislature in respect of the two subsections is to provide a summary method of imposing penalty by the Commissioner or a Deputy Commissioner without going through the court proceedings for certain breaches or irregularities committed by the taxpayer. Proper safeguard against abuse is provided by sections 82A(3) and 82A(4).

(3) The crucial part of the procedure is to consider steps (d) and (e). Steps (b) and (c) being carried out by a different person will not cause injustice or unfairness to the taxpayer since the person who makes the assessment will invariably have to study the whole case as well as the representation made by the taxpayer before he decides whether he should impose the additional tax and if so, how much. The taxpayer's protection is that the assessment may only be done by the personal action of the Commissioner or his deputy.

(4) Sections 82A(3) and 82A(4) are therefore directory and not mandatory (Howard v Bodington (1877) 2 PD 203; London and Clydeside Estates Ltd v Aberdeen DC [1979] 3 All ER 876 considered). Non-compliance will not cause prejudice and will not nullify the assessment process and the imposition of additional tax (D15/98 not followed).

Grounds of appeal

(1) The Revenue invoked section 58(4) of the IRO to prove service of the notice of intention to assess additional tax and hence the burden of proving that it had not received the notices was shifted to the taxpayer. The taxpayer however failed to discharge the burden.

(2) The Board is not the right forum to discuss whether the system of tax collection is good or bad. The Board is only charged with the duty to find out whether the assessment is correct and proper. This complaint is not considered to be a ground of appeal.

(3) Many cases in the past have decided in the event of late filing, the amount of tax eventually assessed is regarded as the amount of tax undercharged. The rationale behind the decision has been expressly and clearly stated in D40/94 and the Board has no reason to deviate from such finding (D40/94 followed).

(4) The additional taxes imposed are 9.77% and 9.84% respectively of the taxes that would have been undercharged for the years of assessment 1994/95 and 1995/96 which are not excessive or unreasonable.

Appeal dismissed.

Cases referred to:

D15/98, IRBRD, vol 13, 163
Howard v Bodington (1877) 2 PD 203
Wang v CIR [1995] 1 All ER 367
London and Clydeside Estates Ltd v Aberdeen DC [1979] 3 All ER 876
D40/94, IRBRD, vol 9, 269

Herbert Li of Department of Justice for the Commissioner of Inland Revenue.
A P Fahy of Messrs A Fahy & Co for the taxpayer.

Decision:

Appeal

1. This is an appeal by a company ('the Taxpayer') against the assessments made under section 82A of the Inland Revenue Ordinance ('the Ordinance') for additional taxes imposed on the Taxpayer for the years of assessment 1994/95 and 1995/96.

Proceedings

2. The Taxpayer was represented by Mr Fahy of Messrs A P Fahy & Co. Mr Fahy did not appear to us that he was familiar with the procedure of the Board. He failed to ask his witness the relevant questions. He did not organise his documents in an orderly manner and some of the documents which he presented to the Board appeared four or five times in the same bundle. He made long submission as his opening address and was not able to make effective submission to sum up his case at the end of the hearing. To avoid unnecessary interruption at the hearing we deviated from the usual practice and allowed Mr Fahy to conduct his case in the manner as he considered appropriate provided that his client and the Revenue were not prejudiced by our relaxation of the rules.

Preliminary issue

3. The Board was fully aware of the decision made by a differently constituted Board in D15/98, IRBRD, vol 13, 163. The Board in that case ruled that the assessments were invalid on the ground that the Revenue had failed to follow the procedure and the provisions in the IRO in that the person who issued the notice under section 82A(4) and the person who made the assessment for additional tax were two different persons while the law required that it should be one and the same person, either the Commissioner or a Deputy Commissioner. The present case has the same situation and raises the same issue. Before the hearing the Board through its clerk notified the parties that it intended to take this as a preliminary issue. The Revenue was presented by Mr Herbert Li, Senior Government Counsel, who made very thorough and persuasive submission while Mr Fahy could hardly give us any assistance on this issue.

4. The following are undisputed facts relating to the notices and assessments:

(i) For the year of assessment 1994/95, the notice dated 7 February 1996 under section 82A(4) was issued in the name of the then Commissioner (Anthony Au-Yeung) and the assessment dated 8 August 1996 was issued in the name of the then Deputy Commissioner (Wong Ho Sang).

(ii) For the year of assessment 1995/96, the notice dated 24 October 1996 under section 82A(4) was issued in the name of the current Commissioner (Wong Ho Sang) and the assessment dated 13 January was issued in the name of a Deputy Commissioner (Sin Law Yuk Lin).

5. It is also not disputed that section 82A of the IRO is a penalty section. It is trite to say that imposing penalty is always a prerogative reserved for the court but in the present case the statute expressly states that it be exercised by the Commissioner or a Deputy Commissioner personally to impose additional tax as penalty in appropriate cases. The legislature has considered it appropriate to lay down certain procedural rules for the person who makes the decision to follow with a view, we believe, that fairness be maintained and that the cases be dealt with expeditiously. In addressing this issue the Board has in mind two other sections which are similar, that is, sections 80 and 82 but the power is exercised by court. It will be helpful for the purpose of analysis to make comparison of the court procedure with the rules laid down by section 82A to see whether justice can be maintained even if there is certain irregularity.

Comparison

6. The court procedure for summary hearing can be roughly divided into the following steps:

(i) The prosecution to adduce evidence and prove its case;

(ii) The court will consider and rule whether there is a prima facie case;

(iii) The defendant will be invited to consider whether to give evidence;

(iv) The court will deliberate whether to convict the person;

(v) If convicted, the defendant is invited to make submission for mitigation;

(vi) The court considers what will be the appropriate sentence.

7. In the case D15/98 five mandatory chronological steps have been identified to be observed prior to imposition of additional tax under section 82A and we have made some slight alteration for the purpose of comparison:

(a) Presentation of the relevant facts of the case to the Commissioner or Deputy Commissioner about the irregularities relevant to section 82A(1);

(b) The forming of an intention on the part of the Commissioner or a Deputy Commissioner to assess additional tax in respect of such irregularities (section 82A(4)(a)(i));

(c) Causing the despatch of a notice in compliance with the specific requirements to the taxpayer in question (section 82A(4)(a));

(d) The consideration by the Commissioner or a Deputy Commissioner of the taxpayer's representations (section 82A(4)(b));

and (e) The imposition of additional tax by the Commissioner personally or a Deputy Commissioner personally.

In D15/98, it has been decided that steps (c) to (e) above have to be considered and handled by the same person. Following the reason for the decision we believe that step (b) should also be included. In the present case it was confirmed to us that the steps (b) to (e) had been handled by the Commissioner or a Deputy Commissioner personally. We have no reason to doubt this and we need not rely on the presumptions under section 38 of the Interpretations and General Clause Ordinance or that under section 58 of the IRO. The question we have to decide is whether the assessments are valid if steps (b) and (c) are performed by one person and steps (d) and (e) by another assuming both persons are within their powers to carry out the functions stipulated in that part of the IRO.

8. The Revenue's arguments summarised in paragraph 14 of Mr Li's written submission are set out below with some additional remarks made by us as shown in square brackets:

'(i) As a matter of construction, section 82A does not require the self same taxing officer to perform all the last three steps (c) to (e) [but the presiding Chairman queried whether it should include (b) as well];

(ii) Alternatively, the said requirement is not mandatory but directory;

(iii) Alternatively, if the said requirement was mandatory, section 63 of the IRO would cure any such defect arising from the giving of the notices in the present case [we would like to add, ***'and also any defect arising from making of the assessments'****].'*

Construction of section 82A

9. The decision in D15/98 cited a passage from Halsbury' Laws of England Vol 44 at paragraph 912 as its main argument:

> *'Taxing statutes construed strictly. The language of a statute imposing a tax, duty or charge must receive a strict construction in the sense that there is no room for any intendment, and regard must be had to the clear meaning of the words. If the Crown claims a duty under a statute, it must show that that duty is imposed by clear and unambiguous words, and where the meaning of the statute is in doubt, it must be construed in favour of the subject, however much within the spirit of the law the case might otherwise appear to be; but a fair and reasonable construction must be given to the language used without leaning to one side or the other side.'*

We accept that this is the guiding principle of interpretation and construction of taxing statutes. We intend to go through the whole process and analyse whether such way of interpretation and construction is appropriate in the present case.

10. We begin by setting out extracts of the relevant subsections for consideration:

Subsection 82A(3)

An assessment of additional tax may be made only by the Commissioner personally or a deputy commissioner personally.

Section 82A(4)

Before making an assessment of additional tax the Commissioner or a deputy commissioner, as the case may be, shall –

(a) cause notice to be given to the person he proposes so to assess which shall –

(i) inform such person of the alleged incorrect return, …… in respect of which the Commissioner or a deputy commissioner intends to assess additional tax under subsection (1);

(ii) include a statement that such person has the right to submit written representations to him with regard to the proposed assessment on him of additional tax;

(iii) specify the date … … by which representations … … must be received.

(b) consider and take into account any representations which he may receive under paragraph (a) from or on behalf of a person proposed to be assessed for additional tax.

11. Mr Herbert Li for the Revenue expressly conceded in paragraph 10 of his submission: 'The provisions under section 82A(3) and (4) obviously can be applied to cover cases where the self same officer carries out all of the said 3 functions (that is, paragraphs 7(c), (d) & (e) above).' We trust that he has no quarrel to include step (b) as well. However, he submits that for various practical reasons the functions cannot be discharged by the same person efficiently. With due respect we do not think administrative efficacy has any direct bearing on the construction and interpretation of a statutory provision. He gave several examples now cumbersome it would be if the subsections were given their strict interpretation but we do not think the difficulties could not be avoided and the problems were insurmountable.

12. He further submits that these two subsections should be construed separately; there is no link between subsections 3 and 4. We find difficulty in such argument: in subsection (4) there is a phrase 'as the case may be' which qualifies the Commissioner and a Deputy Commissioner. At least one member of the Board considers that the phrase forms the link between the two subsections; otherwise the whole phrase becomes superfluous and redundant. The Board does not have a consensus view on this issue. We intend to proceed on the assumption that there is irregularity and that it should be one person to perform all the four functions as set out in steps (b) to (e) above.

Mandatory or Directory

13. It is Mr Li's submission for the Revenue that *'the requirement, namely that a section 82A(4)(a) notice to a taxpayer must be caused to be given by the self same taxing officer who subsequently personally considers the taxpayer's representations and makes the assessment of additional tax, is merely directory.'* For the purpose of academic exposition it is helpful to classify the different types of legislation into directory and mandatory. But it is illogical to think that if the legislation is directory its provisions need not be followed strictly. Legislation is legislation and it is meant for people to follow. There should not be a variance in the degree of obligation just because the section is directory. We believe that the classification of legislation into directory and mandatory is the result of generalisation of certain judicial findings. It is the consequence that justifies the classification, and not the classification that justifies the consequence. It will be more fruitful if we look at Mr Li's submission in a different way and begin with the well known dicta of Lord Penzance in Howard v Bodington (1877) 2 PD 203 at pages 210-211 (quoted with approval in Wang v CIR [1995] 1 All ER 367 at 275f-376c):

> *'The real question in all these cases is this: A thing has been ordered by the legislature to be done. What is the consequence if it is not done? … …There may be many provisions in Acts of Parliament which, although they are not strictly obeyed, yet do not appear to the Court to be of that material importance to the subject-matter to which they refer, as that the legislature could have intended that the non-observance of them should be followed by a total failure of the whole proceedings …… in each case you must look to the subject matter; consider the importance of the provision that has been disregarded, and the relation of that provision to the general object intended to be secured by the*

> *Act; and upon review of the case in that aspect decide whether the matter is what is called imperative or only directory.'*

We accept that statutory requirements can be of many different kinds with different degrees of obligation and different results flowing from a failure with the obligation. We support the view of Lord Hailsham of St Marylebone LC expressed in the London and Clydeside Estates Ltd v Aberdeen DC [1979] 3 All ER 876 at 883 which is also quoted in Wang's case:

> *'In such cases, though language like* ***"mandatory"****,* ***"directory"****,* ***"void"****,* ***"voidable"****,* ***"nullity"*** *and so forth may be misleading in effect if relied on to show that the courts, in deciding the consequences of a effect in the exercise of power, are necessarily bound to fit the facts of a particular case and a developing chain of events into rigid legal categories or to stretch or cramp them on a bed of Procrustes invented by lawyers for the purposes of convenient exposition …… '*

14. The general intent of the legislature in respect of the two subsections is to provide a summary method of imposing penalty by the Commissioner or a Deputy Commissioner without going through the court proceedings for certain breaches or irregularities committed by the taxpayer. Proper safeguard has to be provided against abuse and hence section 82A(3) and (4). When we go through the process as provided in the two subsections with the court procedure in mind, we may find that step (b) is similar to the court's adjudication whether there is a prima facie case. When it is so decided the defendant is required to present his case if he so wishes; under section 82A(4)(a) the Commissioner or a Deputy Commissioner, as the case may be, shall cause notice to be given, inter alia, reminding the taxpayer his right to submit written representations. Upon receipt of any reply or upon expiry of the statutory period in default of a reply the Commissioner or the Deputy Commissioner, as the case may be, has to consider all circumstances of the case including any representation submitted and makes the assessment. These two steps of (d) and (e) are analogous to the steps (iv) to (vi) of the court procedure. The question we have to ask is that if the different functions are carried out by two different persons – one is to decide the prima facie case and the other is to decide the verdict and sentence, will the defendant be prejudiced? In normal criminal cases the answer is a definite affirmative "yes". But, the two steps (b) and (c), that is, considering whether to issue notices and causing issue of the notice itself are almost routinely carried out as a matter of course. The crucial part of the procedure is to consider the taxpayer's representation and imposition of additional tax (steps (d) and (e)).

15. Mr Li for the Revenue submits that steps (d) and (e) are invariably done by the same person, which we have no reason to doubt and section 38 of Chapter 1 presumes it in its favour. The key issue is that steps (b) and (c) have been carried out by a person, different from the one who makes the assessment. Will such difference invalidate the assessment on the ground of non-compliance of the statutory provision? In the word of Lord Pensance, *'what is the consequence if it is not done?'* Will it cause injustice or unfairness to the taxpayer? We find none. Although the person who has caused the notice to be issued under

section 82A(4)(a) is not the same person who makes the assessment the latter will invariably have to study the whole case as well as the representation made by the taxpayer before he decides whether he should impose the additional tax and if so, how much. The person who makes the assessment has to know all the fact, deliberate on them and make decision. The taxpayer is not prejudiced in any way by having two different persons carrying out different functions which the statute may contemplate to be carried out by one. The taxpayer's protection is that the assessment of additional (penalty) tax may only be done by the personal action of the Commissioner or his deputy. Mr Chadha assured the Board that this was done in every case.

16. Having come to the aforesaid conclusion we can safely classify that the provisions are directory and not imperative. Non-compliance will not cause prejudice and will not nullify the assessment process and the imposition of the additional tax. The Revenue also relies on section 63 which states:

> *'No notice, assessment, certificate, or other proceeding purporting to be in accordance with the provisions of this Ordinance shall be quashed, or deemed to be void or voidable, for want of form, or be affected by reason of a mistake, defect, or omission therein, if the same is in substance and effect in conformity with or according to the intent and meaning of this Ordinance, and if the person assessed or intended to be assessed or affected thereby is designated therein according to common intent and understanding.'*

For reasons above given we rule that both the notices and the assessments are valid although they are issued and made by different persons. The decision in D15/98 has very high persuasive power but it is not binding on us. We find that there are aspects of law that have not been raised or fully addressed by the parties concerned. We have decided to deviate from the ruling made in that decision.

Grounds of appeal

17. Having dealt with the preliminary issue we now consider the specific grounds of appeal in this case. The contents of the letters that contain the grounds of appeal are confusing. We have difficulty in sorting out what they are. The Revenue thought that the Taxpayer had advanced only two grounds as set out in Mr Chadha's submission for the Revenue:

> '*(1) The balance of tax due was nil. Therefore there was no tax undercharged and the Taxpayer was not liable to be assessed under section 82A.*
> *(2) No notice of intention to assess additional tax under section 82A(4) of the IRO was given.'*

18. Mr Fahy for the Taxpayer definitely said much more than these two grounds. He pleaded that the Taxpayer was incorporated in Hong Kong on 1 September 1967 and had been carrying on the business of marine engineering and naval architecture in Hong Kong

for the past 28 years. During this period the Taxpayer had very good record of filing tax returns: they had never been late and had never filed any incorrect or inaccurate account. For the years in question, the major shareholder and director of the Taxpayer, was planning to retire and leave Hong Kong. He had to find a successor to continue with his business. The buyer had to be a recognised engineer in that particular area of practice. He was heavily involved in his personal as well as business affairs. The Taxpayer employed staff to upkeep and maintain the accounts and file the returns. The delay was excusable. The Taxpayer also argued that the Revenue should have given warning before taking punishment action for the delay. The Taxpayer should have been given a chance. Further Mr Fahy also attacked the present system of tax collection that in his client's case a large amount was paid on provisional basis for the future tax lability. On this advanced payment the Government paid no interest. The system was unfair to the Taxpayer.

Liability

19. As the Taxpayer did not admit liability, we have to consider both the statutory defence whether there is ***'any reasonable excuse'*** and the different grounds of appeal. From what we have heard and what we have seen we find that none is sustainable except the general allegation that the Revenue had not given notices of warning to impose additional taxes. We doubt very much the allegation is true.

20. In reply to the allegation Mr Chadha pointed out the following passage in the first paragraph of his letter dated 6 November 1996:

> *'With reference to your letter dated 24 October 1996, please note that we replied to a similar letter on 28 March 1996 objecting to your attempt to raise the profits tax rate … …'*

We have gone through the whole bundle of documents and can only find one document from the Revenue which bears the date 24 October 1996 and that is the notice issued pursuant to section 82A(4)(a). It is the notice which was issued by Wong Ho Sang referred to in paragraph 4(ii) above. It is the document which has appeared five times in the bundle Mr Fahy produced. There was no reason for him to complain for not having received the notice for the year of assessment 1995/96.

21. As to the earlier notice for the year of assessment 1994/95 we can imply from the above passage quoted that the Taxpayer or Mr Fahy had received it. In that passage he said that he had replied and raised objection. We have seen the demeanour of Mr Fahy who handled all the tax affairs for the Taxpayer and the way how Mr Fahy conducted his case. We find that it is more likely than not that the notices were lost by Mr Fahy himself. The Revenue claimed that it had been posted, and invoked section 58(4) of the IRO to prove service. The burden now shifts to the Taxpayer to prove that it had not received the notices. We find that it has failed to discharge the burden.

22. Mr Fahy attacked the system of tax collection. The Board is not the right forum to discuss whether the system is good or bad. We are only charged with the duty to find out

whether the assessment is correct and proper. We do not consider the attack to be a ground of appeal.

23. Another ground of appeal is that the balance of tax due was nil and there was no tax undercharged. Many cases in the past have decided that in the event of late filing the amount of tax eventually assessed is regarded as the amount of tax undercharged. The rationale behind the decision has been expressly and clearly stated in D40/94, IRBRD, vol 9, 269 at 273, *'The IRO had set up a theoretical situation for the calculation of penalty tax. The legislature has provided a simple and expedient way of calculating the maximum amount which the Commissioner can impose. The legislature has chosen to adopt a theoretical situation of what would be the case if the failure to do something had never been found out. Obviously the failure has been found out but that is not material. If the taxpayer had never filed its tax return then theoretically it would never have paid any tax. That being the case it must follow logically that the amount of tax which would have been undercharged would have been the full amount of the tax which was eventually assessed.'* We have no reason to deviate from such finding.

Quantum

24. All the other factors which Mr Fahy has pleaded have been considered by the Board. There are many former decisions that the usual tariff for a first offender is 10% of the tax that would have been undercharged. In the present case the additional taxes imposed are $25,000 and $16,000 representing 9.77% and 9.84% respectively of the taxes that would have been undercharged for the years of assessment 1994/95 and 1995/96 respectively. We do not think that they are excessive or unreasonable.

Decision

25. Having considered all the circumstances of the case we find that the Taxpayer has failed to discharge his burden of proof as required by section 68(4) of the IRO. Accordingly we dismiss the appeal.