Case No. D15/98

Penalty Tax – failure by a director to report chargeability to salaries tax – voluntary disclosure and invite the Commissioner to issue additional salaries tax assessment – imposition of additional tax may only be made by the Commissioner or a Deputy Commissioner personally – this power cannot be delegated to any other person – whether the Second Notice in this case is a valid notice – voluntary disclosure is a good mitigating factor – tariff rate for simple omission of income – section 82A of the Inland Revenue Ordinance.

Panel: Ronny Wong Fook Hum SC (chairman), Andrew Mak Yip Shing and Anthony So Chun Kung.

Date of hearing: 20 December 1997.
Date of decision: 16 April 1998.

At all material times, both Mr Y and Ms Z, who were married couples, were directors of Company X. They were collectively called as taxpayers.

On 28 May 1996, Ms Z submitted a tax return in respect of her earnings for the year of assessment 1995/96. She reported to the Revenue her salary from Company X for the period between 1 April 1995 to 31 March 1996 at $160,000 ("the reported income").

By a notice of assessment dated 7 October 1996, Ms Z was assessed a sum of $11,698 on the basis of her reported income.

On 28 October 1996, on the basis of an amended IR 56B Form, Company X, through its authorized representative, Messrs W H Lam & Co, invited the Commissioner to issue additional salaries tax assessments for the year of assessment 1995/96 to the taxpayers ("the 28 October 1996 letter). The said amended IR 56B Form was a return of Company X by Mr Y Reporting the earnings of Ms Z for the year ended 31 March 1996. Apart from salary in the sum of $160,000, Ms Z was further paid a sum of $400,000 by way of directors' bonus on 16 November 1995.

By notice of additional assessment dated 22 November 1996, Ms Z was charged additional tax in the sum of $75,600.

On 21 May 1997, the Commissioner gave notice ("the First Notice") to Ms Z of his intention to assess additional tax under section 82A of the Inland Revenue Ordinance ("IRO"). Ms Z, through Messrs W H Lam & Co, made written representations. After considering these representations, the Deputy Commissioner by notice dated 8 August 1997

imposed additional tax in the sum of $7,500 ("the Second Notice"). Ms Z appealed before the Board of Review against the imposition of such additional tax.

Held:

1. In construing section 82A of the IRO, the Board have borne in mind the principle outlined in paragraph 912 of Halsbury's Laws of England Vol 44, that is, taxing statutes have to be construed strictly.

2. The Board were of the view that section 82A(3) of the IRO stipulated that imposition of additional tax might only be made by the Commissioner or a Deputy Commissioner personally. The word 'personally' made it clear that the power could not be delegated to any other person. In this connection the Board would also refer to section 3A of the IRO which reinforces this view. Before the relevant taxing officer (the Commissioner or a Deputy Commissioner) exercises such power, that relevant taxing officer must comply with two conditions. First, he must cause a notice containing the requisite particulars to be given to the taxpayer in question. Secondly, he must consider the representations which he may receive from the taxpayer.

3. The Board were of the view that these three functions, namely, causing the dispatch of the notice; consideration of the representations and imposition of additional tax must be discharged by the self same relevant taxing officer.

4. In the present case, the relevant taxing officer was the Deputy Commissioner. The Second Notice was sent in her name. The Board did not think that there is any evidence to suggest that the Deputy Commissioner caused the First Notice containing the requisite particulars to be sent to Ms Z. Neither the terms of the First Notice nor the Second Notice certainly contained such suggestion. It was difficult to accept that a Deputy Commissioner caused the Commissioner to send a notice. The Revenue's argument that the functions envisaged by section 82A of IRO could be performed by different officers reinforced the view that the relevant taxing officer in this case did not cause the First Notice to be issued.

5. Therefore, the Board were of the view that the Second Notice in this case was not a valid notice and Ms Z was not liable to the additional tax in question.

6. As to the matter of quantum, the Board saw no force in the argument that Ms Z was under severe mental pressure at the time when the tax return was submitted. The precise date when she gave birth to her child was left vague. The sum omitted was substantial. It was paid to her in November 1995.

7. With respect to the 28 October 1996 letter, the Board was of the view that the letter was an attempt, albeit an inelegant one, on Ms Z's behalf to rectify the position and make voluntary disclosure.

8. Voluntary disclosure was a good mitigating factor in Hong Kong tax case.

9. Recent case in Hong Kong showed a consistent tariff rate for simple omission of income at 10% of the tax undercharged.

Appeal allowed.

Cases referred to:

BR 23/75, IRBRD, vol 1, 187
D4/94, IRBRD, vol 9, 75
D75/94, IRBRD, vol 10, 39
D52/95, IRBRD, vol 11, 7
D126/95, IRBRD, vol 11, 277
D8/96, IRBRD, vol 11, 400
D80/96, IRBRD, vol 11, 714
D104/96, IRBRD, vol 12, 74
D105/96, IRBRD, vol 12, 79

Go Min Min for the Commissioner of Inland Revenue.
Lam Wai Hay of Messrs W H Lam & Co for the taxpayer.

Decision:

The Background

1. Company X is a company incorporated on 5 May 1992. At all material times, its directors were Mr Y and Ms Z. Mr Y and Ms Z are husband and wife.

2. On 28 May 1996, Ms Z submitted a return in respect of her earnings for the year of assessment 1995/96. She reported to the Revenue her salary from Company X for the period between 1 April 1995 to 31 March 1996 at $160,000. Messrs W H Lam & Co was named as her authorised representative.

3. By a notice of assessment dated 7 October 1996, Ms Z was assessed $11,698 on the basis of her reported income of $160,000.

4. On 28 October 1996, Messrs W H Lam & Co sent a letter to the assessor in these terms:

'Your Ref: E R No.

The Assessor,
Inland Revenue Department,
Revenue Tower,
5, Gloucester Road,
Wanchai,
Hong Kong.

Sir,

Company X

On behalf of the abovenamed clients, we enclose herewith Amended Forms IR 56B dated 26 October 1996 Sheets No. 1 and No. 2 to supersede the former ones.

Please issue additional salaries tax assessments for 1995/96 (Final) to the respective taxpayers for payment

Your faithfully,

W H Lam & Company.'

5. The Amended IR 56B Form enclosed was a return of Company X signed by Mr Y reporting the earnings of Ms Z for the year ended 31 March 1996. Apart from salary in the sum of $160,000, Ms Z was further paid a sum of $400,000 by way of directors' bonus on 16 November 1995.

6. By notice of additional assessment dated 22 November 1996, Ms Z was charged additional tax in the sum of $75,600.

7. On 21 May 1997, the Commissioner gave notice ('the First Notice') to Ms Z of his intention to invoke the provisions of section 82A and invited representations from Ms Z. The First Notice contains the following paragraphs:

'**I am of the opinion** that you have, without reasonable excuse, made incorrect tax return …

You are liable to be assessed under section 82A …

You are hereby informed that **I propose to assess** additional tax under this section in respect of the said incorrect return.

> You have the right to submit **written representations to me** with regard to the proposed assessment of additional tax, which will be considered and taken into account before any assessment of additional tax is actually made. Please note that any such written representations must be **received by me** within one month from the date of this Notice.
>
> WONG HO SANG
> Commissioner of Inland Revenue'
>
> *(emphasis applied)*

8. By letter dated 20 June 1997, Messrs W H Lam & Co made the following submissions on behalf of Ms Z:

a. Ms Z gave birth to a baby '[d]uring the period of March and April 1996' and the omission arose as a result of 'excessive mental pressure'.

b. 'Our client discovered the omission immediately after receiving the notice of assessment dated 7 October 1996 and instructed us to report the omission to your assessor and made a request for additional assessment on her behalf.' Reliance was then placed on their letter dated 28 October 1996. Messrs W H Lam & Co pointed out that their letter was sent before the assessment had become final and conclusive under section 70 of the Inland Revenue Ordinance.

9. After considering these representations, the **Deputy** Commissioner by notice dated 8 August 1997 ('the Second Notice') imposed additional tax in the sum of $7,500. The commencing paragraph of the Second Notice reads as follows:

> 'With reference to the notice of 21 May 1997 under section 82A(4) of the Inland Revenue Ordinance (chapter 112), after considering and taking into account representations made by you or on your behalf, I assessed you to additional tax under section 82A of the Inland Revenue Ordinance in the sum of $7,500 and you are now required to pay this sum on or before 19 September 1997.'

10. Ms Z appealed before us against the imposition of such additional tax.

Submissions on behalf of Ms Z

11. On liability: It was contended on behalf of Ms Z that the Second Notice is invalid. It was issued by the Deputy Commissioner who did not issue the First Notice.

Implicit in this submission is the contention that the First and the Second Notices must be issued by the self-same officer.

12. On quantum: It was urged on behalf of Ms Z that the amount of additional tax is excessive bearing in mind that Ms Z had an unblemished record in relation to her tax affairs. The pleas outlined in the letter of 20 June 1997 were repeated. It was further pointed out that the omission did not cause any loss to the public as the due date under the additional assessment of 22 November 1996 was the same as that for the initial assessment of 7 October 1996.

On liability

13. Section 82A(1) of the Inland Revenue Ordinance ('the IRO') provides:

> *'Any person who without reasonable excuse –*
>
> *(a) makes an incorrect return …*
>
> *Shall, if no prosecution under section 80(2) or 82(1) has been instituted in respect of the same facts, be liable to be assessed under this section to additional tax of an amount not exceeding treble the amount of tax which-*
>
> > *(i) has been undercharged in consequence of such incorrect return … or would have been so undercharged if the return … had been accepted as correct …'*

14. Section 82A(3) of the IRO provides:

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

15. Section 82A(4) of the IRO provides:

> '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 had the right to submit written representations **to him** with regard to the proposed assessment on him of additional tax;

(iii) …

(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.'

(emphasis applied)

16. The Revenue submits that:

a. The fact that the provision for the issuance of the Second Notice [section 82A(3)] precedes the provision in relation to the issuance of the First Notice [section 82A(4)] suggests that the two provisions are independent of each other. The Legislature did not adopt a chronological order for these provisions.

b. Both section 82A(3) and section 82A(4) refer to 'a' Deputy Commissioner instead of 'the' Deputy Commissioner. There is no requirement that the Deputy Commissioner who issued the Second Notice should be the same as the one who issued the First Notice.

c. The words 'cause notice to be given' in section 82A(4)(a) suggest that the First Notice may be given by someone at the direction of the Commissioner.

17. The Revenue's contentions envisage the following 'chronological' steps to be observed prior to the imposition of additional tax:

a. The submission by a taxpayer of an incorrect return.

b. The forming of an intention on the part of the Commissioner or a deputy commissioner to assess additional tax in respect of such incorrect return.

c. The despatch of a notice in compliance with the specific requirements to the taxpayer in question.

d. The consideration by the Commissioner or a deputy commissioner of the representations from the taxpayer in question.

e. The imposition of additional tax by the Commissioner personally or a deputy commissioner personally.

The Revenue's argument suggests that each of the steps outlined in sub-paragraphs b – e above can be performed by a different officer. The terms of the First Notice quoted in paragraph 7 above is inconsistent with this stance. The Commissioner or a deputy commissioner is empowered to impose additional tax not exceeding treble the amount of tax undercharged. Such imposition is not a mechanical process divorced from the

representations of the taxpayer pertaining to the presence or otherwise of 'reasonable excuse' and the particular circumstances of the individual case.

18. In construing the section in question, we have borne in mind the principle outlined in **paragraph 912 of Halsbury's Laws of England Vol 44**

> *'**Taxing statutes construed strictly**. The language of a statue 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.'*

19. We are of the view that section 82A(3) provides that imposition of additional tax may only be made by the Commissioner or a deputy commissioner personally. The word 'personally' makes it clear that the power cannot be delegated to any other person. In this connection we would also refer to section 3A of the IRO which reinforces this view. Before the relevant taxing officer (the Commissioner or a deputy commissioner) exercises such power, that relevant taxing officer must comply with two conditions. First, he must cause a notice containing the requisite particulars to be given to the taxpayer in question. Secondly, he must consider the representations which he may receive from the taxpayer. We are of the view that these three functions, namely, causing the despatch of the notice; consideration of the representations and imposition of additional tax must be discharged by the self same relevant taxing officer.

20. Applying this construction to the facts of this case, the relevant taxing officer is the deputy commissioner. The Second Notice was sent in her name. Is there any evidence to suggest that she caused the First Notice containing the requisite particulars to be sent to Ms Z? We think not. The terms of the First Notice and the Second Notice certainly contain no such suggestion. It is difficult to accept that a deputy commissioner causes the Commissioner to send a notice. The Revenue's argument that the functions envisaged by section 82A could be performed by different officers reinforces the view that the relevant taxing officer in this case did not cause the First Notice to be issued.

21. For these reasons we are of the view that the Second Notice in this case is not a valid notice and Ms Z is not liable to the additional tax in question.

Quantum

22. As the matter was extensively canvassed before us, we shall deal shortly with this issue.

23. We see no force in Ms Z's contention that she was under severe mental pressure at the time when the return was submitted. The precise date when she gave birth to her child was left vague. We do not know whether the child was born in March or April 1996. The return was submitted in late May 1996. The sum omitted was substantial. It was paid to her in November 1995.

24. The thrust of her case rests with the letter of Messrs W H Lam & Co dated 28 October 1996. That letter was sent after the notice of assessment of 7 October 1996. It was a letter sent on behalf of Company X. The file reference has no connection whatsoever with Ms Z. However, the last paragraph of that letter contains an express invitation for 'additional salaries tax assessment … to the respective taxpayers for payment.' We have some sympathy with Ms Z's contentions that a pragmatic view must be taken. The letter was an attempt, albeit an inelegant one, on her behalf to rectify the position.

25. The Revenue maintains that the letter of 28 October 1996 is wholly irrelevant. The additional tax was imposed without regard to that matter.

26. Had it been necessary for us to decide this issue, we would have attached some but limited weight to the letter of 28 October 1996.

27. Voluntary disclosure is a good mitigating factor in Hong Kong tax case (see BR 23/75, IRBRD, vol 1, 187).

28. Recent cases in Hong Kong show a consistent tariff rate for simple omission of income at 10% of the tax undercharged. The following cases exemplify that level of penalty.

a. D4/94, IRBRD, vol 9, 75;

b. D75/94, IRBRD, vol 10, 39;

c. D52/95, IRBRD, vol 11, 7;

d. D126/95, IRBRD, vol 11, 277;

e. D8/96, IRBRD, vol 11, 400;

f. D80/96, IRBRD, vol 11, 714;

g. D104/96, IRBRD, vol 12, 74 and

h. D105/96, IRBRD, vol 12, 79

Voluntary disclosure as a mitigating factor does not play any part in these cases.

29. We would attach some weight to the letter of 28 October 1996 as an attempt on behalf of Ms Z to make voluntary disclosure. Had it been necessary for us to decide this issue, we would have reduced the additional tax to $6,000.

Our Order

30. For reasons stated in paragraph 21 of this decision, we allow this appeal and discharge the additional tax accordingly.