Case No. D 2/81

Board of Review:

L. J. D'Almada Remedios *Chairman*; David K. P. Li; J. G. Oliver; B. H. Tisdall *Members*.

10 April 1981.

Company – profits tax – unexplained cash credits to current accounts of individual Directors – additional assessment under s. 82A of Inland Revenue Ordinance.

The appellant is the permanent governing director of a company and signed all profits tax returns which showed assessable profits for years 1973/74 and 1974/75, no profits for 1975/76 to 1977/78 and for 1977/78 a loss of $409,463.

The Inland Revenue investigated the company's affairs in June 1979. In November 1979 the Appellant submitted a return showing profits of $139,623 for 1978/79. The Inland Revenue raised additional assessments after investigation and on basis of unexplained cash credits to current accounts of individual directors. The Appellant agreed that the losses for 1977/78 were only $49,263 and not $409,463.

The Deputy Commissioner invoked s. 82A of the Inland Revenue Ordinance and imposed additional tax of $14,000 for the year 1977/78.

Held: Since in any event no profit has been made for year 1977/78 and no tax is payable for that year then no penalty can be imposed in respect of that year.

Appeal upheld.

L. Mckeon for the Commissioner of Inland Revenue.
Lawrence Cheung & Co. for the Appellant.

Reasons:

The Company was incorporated on the 1st of January, 1973. It commenced trading as a men's clothing boutique on the 1st of April 1973 after taking over a partnership business as a going concern.

The Appellant is the permanent governing director of the Company. The Company's profits tax returns were all signed by him. These returns showed that there were assessable

profits for the first two years (1973/74 and 1974/75). For the years of assessment 1975/76 to 1977/78, the company claimed not to have made any assessable profits. For the year of assessment 1977/78, the company's returns showed a loss of $409,463.00.

The company's financial affairs were investigated by the Inland Revenue Department in June, 1979. In November, 1979, the Appellant submitted a return for the year of assessment 1978/79 which showed profits in the sum of $139,623.00 for that year of assessment. After investigation and on the basis of unexplained cash credits to the current accounts of individual directors, additional/revised assessments were raised on the 25th of January, 1980 in respect whereof the Appellant agreed *(inter alia)* that the company's loss for the year 1977/78 was $49,463 and not $409,463 as shown in the Appellant's returns. So the position in regard to the years of assessment 1977/78 and 1978/79 was as follows:

Year of assessment: 1977/78	
Assessable profits……....	NIL
Loss carried forward……....	$ 49,463
Year of assessment: 1978/79	
Assessable profits……....	$139,623
Loss brought forward……..	$ 49,463
Assessable profits……....	$ 90,160
Tax @ 17% = $15,327	

The Deputy Commissioner, invoking Section 82A of the Inland Revenue Ordinance, imposed additional tax of $14,000 for the year of assessment 1977/78.

The validity of the additional tax for this year of assessment is disputed.

The argument on behalf of the Appellant is that the additional tax of $14,000 should be set aside because the Commissioner is only empowered to exact additional tax by reference to either a percentage or a multiplier (not exceeding 3 times) of the profits that have been understated. If, therefore, there were no assessable profits for 1977/78, the multiplier of or percentage of zero remains zero.

On behalf of the Commissioner, it was contended that Section 82A does not say for what year of assessment additional tax can be imposed. If this argument suggests that additional tax can be charged for any year of assessment which the Commissioner chooses irrespective of whether tax has been undercharged for that year, we do not ascribe to it.

It is further argued on behalf of the Revenue that although no profits were made for the year of assessment 1977/78, the overstatement of the company's loss involves an understatement of the company's income. We find no basis upon which such a conclusion can be drawn. There is no evidence before us to support it; nor do we see how we can be called upon to draw such an inference when the Revenue accepts that there was in fact a loss.

If a loss has been actually sustained, the inflation of that loss need in no way to be related to the concealment of income.

The additional tax which has been levied is for 1977/78 and it is accepted that for that year of assessment no profits have been made. So no tax is payable for that year of assessment. If no tax can be charged because no profits have been made, no penalty can be imposed – at least not for that year. If, for example, the Appellant had wholly discontinued his business after filing his return which overstated his loss, no additional tax can be imposed. Taking a step further, if a taxpayer having overstated his loss for 1977/78 but before or when submitting his return for the next year, he, with 'locus poenitientiae' informs the assessor that he has overstated his loss for 1977/78 and discloses his actual loss, again no additional tax can be charged.

"Additional tax" is referable to a further tax (albeit in the nature of a penalty) for the year in which the tax has been undercharged. In the clear terms of Section 82A, the Commissioner is required to determine the quantum of that additional tax by reference to a base figure which is the amount of tax undercharged for that year and then take a multiplier or percentage of that figure.

It appears not to be disputed by the Revenue that the tax would have been undercharged had the return of 1977/78 been accepted as correct would be the tax for the year 1978/79 because the disclosed profit for 1978/79 would have resulted in a nil assessment occasioned by the overstated loss of the previous year setting off the returned profits: Section 19. There could be some justification for imposing additional tax for the year 1978/79 as there would have been an undercharge of tax for that year if the overstated loss of the previous year had been accepted. But we do not endorse approval of a levy of additional tax for a year of assessment in which it was not exigible. A taxpayer is entitled to know for what year of assessment it is being levied and if it is levied for a wrong year of assessment, it is our duty to say so. We do not feel inclined to approved or encourage the setting up of a precedent which is incorrect. It is argued by the Revenue that the imposition of additional tax for 1977/78 when it was not exigible is a type or error to which Section 63 would apply. In our view, an assessment for additional tax for 1977/78 when it was not leviable is not "in substance and effect in conformity with or according to the intent and meaning of the Ordinance".

We would add that the Appellant, exercising his right under Section 82B(2)*(a)*, argues that he is not liable to additional tax for the year of assessment 1977/78. He is not here before us to argue whether he is liable to an additional tax assessment for the year 1978/79 nor does he need to do so as such assessment has not been raised against him. Section 82B(2)*(a)* expressly allows him the right to argue the point he has taken. For the reasons we have given, he has succeeded in his argument. The additional tax of $14,000 for the year of assessment 1977/78 is, therefore, disallowed and set aside.

The Deputy Commissioner's entitlement to charge additional tax for the other years of assessment based on the statement of agreed facts (which we have not found necessary to

set out in this decision) is hereby confirmed as we do not find the additional tax for the other years of assessment to be either invalid or excessive and they are hereby confirmed.