INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D36/88

Assessments – whether the 'final and conclusive' provisions apply to additional assessments – s 70 of the Inland Revenue Ordinance.

Penalty assessment – whether taxpayer could argue that he was not liable to pay tax – ss 70 and 82A of the Inland Revenue Ordinance.

Panel: H F G Hobson (chairman), William Fung Kwok Lun and Ng Yin Nam.

Dates of hearing: 6 and 7 September 1988.
Date of decision: 22 September 1988.

The taxpayer company had been assessed to profits tax as a result of a settlement with the IRD after substantial investigations into its activities. The Commissioner then assessed the taxpayer to penalties, against which the taxpayer appealed.

The taxpayer indicated that it would lead evidence that its directors had omitted to declare profits as a result of a genuine behalf that such profits were not sourced in Hong Kong. Furthermore, the taxpayer intended to show that it had settled the case with the IRD merely to complete the investigations into its activities.

The Commissioner's representative objected to this evidence. He argued that section 70, which provides that assessments are 'final and conclusive', precluded the taxpayer from challenging the validity of the assessments with respect to which the penalties had been imposed.

Held:

(a) The taxpayer would be permitted to lead evidence which was contemporaneous with the preparation of its tax return in order to establish its belief at that time that such profits were not chargeable to tax. Such belief was relevant because it might constitute a 'reasonable excuse' for failing to declare such profits.

(b) However, the taxpayer would not be permitted to argue that the assessment with respect to which the penalty was levied was incorrect.

(c) Evidence as to why the taxpayer had decided to settle its assessment with the IRD would not be relevant for the purpose of establishing the taxpayer's

belief at the time it prepared its profits tax returns, except perhaps for the limited purpose of supporting the credibility of its evidence as to its earlier belief.

(d) The finality provisions of section 70 refer to both original assessments and additional assessments.

[Editor's note: Reference could be made to D29/88, IRBRD, vol 3, 319 where the same issue as in (b) also arose.]

Cases referred to:

BR17/72, IRBRD, vol 1, 97
BR80/76, IRBRD, vol 1, 259
D10/81, IRBRD, vol 1, 404

David Hinchen for the Commissioner of Inland Revenue.
Benjamin Yu instructed by Hastings & Co for the taxpayer.

Decision:

The Taxpayer company at all relevant times was owned by Mr A and Mr B who were also directors of the company. Mr A died intestate on 31 March this year and no grant to his estate has so far been taken out.

The company was assessed to profits tax covering the six years of assessment 1976/77 to 1981/82 ('the profits tax assessments'). We were advised that these assessments were raised in the first instance on the basis of returns submitted by the company but then supplemented by assessments resulting from a settlement between the company and the IRD after some four years of investigations by the IRD into the affairs of the company and into the propriety of the original returns submitted for the company. Taken together, the assessments totalled $8,500,000. The consequential tax of $1,440,760 on this sum has now been paid in full.

Subsequent to the said assessments, the Commissioner of Inland Revenue in August 1981 served notices of under section 82A(4) of the IRO (proposal to levy additional tax) upon Mr A in relation to five of the company's original returns and upon Mr B in relation to the 1980/81 return. The then tax representative of Mr A and Mr B thereupon made representations. However, on 29 September 1981, the Commissioner issued five additional tax assessments ('the penalty assessments') against Mr A and one against Mr B as they were the directors who signed the returns concerned. The penalty assessments involved some $2,100,000 in additional taxes. Mr A and Mr B then gave notice of appeal to the Board of Review.

It was apparent from that notice and was confirmed by Mr Benjamin Yu, the Counsel for Mr B, in his initial address to us that the thrust of the grounds of appeal was that the directors omitted from the returns certain amounts received by the company in the real belief that those amounts were not assessable profits of the company at all because they were remittances of earnings from a group of companies which operated in Ghana and which was owned by Mr A and Mr B and some relatives in Ghana. Put shortly, if such evidence were to be believed, it would constitute 'reasonable excuse' so as to avoid the consequences of section 82A. Mr Yu advised that he would be calling Mr A as well as a member of the company's tax representatives to show that, though those remittances were not Hong Kong sourced, Mr A and Mr B had agreed to settle with the IRD because they were anxious to bring the lengthy investigations to a close.

Mr Yu however was in no position to represent the estate of Mr A as no grant had been taken out. He therefore sought this Board's permission to adjourn the appeal in so far as it related to Mr A's five penalty assessments (pending the grant of letters of administration or a court order whereby the estate could be properly represented on the appeal) but to proceed with Mr B's appeal. We agreed to this proposal.

Preliminary issues

Mr David Hinchen, Crown Counsel appearing for the Commissioner of Inland Revenue, raised a preliminary issue for our determination, namely as to the right of either appellant to adduce the evidence sketched out above. Mr Hinchen contended that, by virture of section 70, the profits tax assessments are final and conclusive for all the purposes of the Ordinance. Accordingly, the appellants cannot adduce evidence which purports to show either that such assessments are incorrect or conversely that the original returns were correct. In support, he cited the Board of Review decisions in BR17/72 and D10/81.

In BR17/72, the appellant's counsel indicated an intention to show the original assessments were excessive. Counsel for the Revenue objected to this approach whereupon the matter (as here) was dealt with as a preliminary issue. The appellant's counsel apparently made it clear he would not be relying on the defence (against the penalty tax) of 'reasonable excuse' but would be submitting that the appellant's original returns were correct. The Board in ruling against the appellant on that aspect made the following points:

> ' In our view, the appellant's original tax returns must be taken to be incorrect. This is a finding implicit from the decision of the former Board and from the nature of the successive proceedings which we have described above. Any evidence or argument seeking to prove or establish the contrary must, of necessity, involve the proposition that the assessable profits determined and confirmed as aforesaid were wrong. That would be violating the provisions of section 70 if they apply to these proceedings, and we hold that they do.

> As to the words "so far as they are applicable" in section 82B(3), we can see nothing in the Ordinance or in the circumstances of this case which make it inappropriate for us to apply the provisions of section 70. It follows that in our opinion the assessments above referred to are final and conclusive for all purposes including any purpose under section 82A and section 82B.
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> Such being our view, we ruled that the appellant was not at liberty to adduce evidence for the purpose of proving (1) that the amount of assessable profits determined and confirmed as aforesaid were excessive or (2) that the original returns filed by the appellant were correct. Although no specific argument was addressed to us on the point of limiting arguments as opposed to evidence, we indicated that what we had stated as set out above might not be inapplicable also to any argument which the appellant might seek to put forward for any of the aforesaid purposes.'

In D10/81, the appellant conducted his own appeal. Mr Hinchen drew our attention to the following passages in the report:

> ' In appealing against the penalty assessments, the appellant's contention is that full disclosure of his income had been made by him as reflected in the returns for which reason he says he is not liable to any penalties. This contention does not hold water. The appellant cannot approbate and reprobate. If a taxpayer agrees to an assessment for tax founded on an Assets Betterment Statement (whether original or revised) and he pays or is paying the tax as assessed, he must be taken to admit that it relates to a liability for which he is chargeable to tax. His liability under the assessment cannot be re-opened. It has become final and conclusive: section 70.'

Mr Hinchen's contention is therefore both straightforward and supported by the above.

Mr Yu in reply however emphasized that his intention with regard to the evidence (herein 'the contemporary evidence') was to show why his clients had an honest belief that the company was not liable to profits tax on the remittances from Ghana. He also said that the evidence (herein the 'ex post facto evidence') would also deal with the reason why the directors had decided to settle with the Revenue.

Mr Yu's argument was that the contemporary evidence, if it was believed, would show that Mr B had a reasonable excuse for making what he believed was a correct return.

As to the aforementioned Board of Review decisions, Mr Yu contended that D10/81 was not a compelling one, the lay taxpayer being unrepresented and such submissions as may have been made being likely to be superficial. We agree with this point and discount the persuasiveness of that decision for those reasons.

The BR17/72 decision followed on from an appeal to another Board of Review which had dealt with the merits of the taxpayer's liability to profits tax on the earnings in question. In consequence of that earlier hearing, the question of such liability was res judicata and (so Mr Yu argued) hence distinguishable from the position before us where there had been no such decision. Rather, the company had agreed to concede liability. We fail to see the merit in this argument because it seems to us that the distinction is one without a difference so far as the finality and conclusiveness of the assessments in BR17/72 and the company's profits tax assessments are concerned.

Mr Yu also sought to persuade us that notwithstanding the stipulation in section 60(1) to the effect that 'the provisions of the Ordinance as to ... appeal and other proceedings are to apply to such additional assessments', section 70 was inapplicable to the profits tax assessments (some of which were evidently by way of additional assessment under section 60) because section 70 did not itself refer to additional assessments, except in the proviso. The argument in this regard seemed to us to be overly sophisticated since there would be no purpose whatsoever in referring to additional assessments in the proviso to section 70 if the earlier portion of that section was not intended to refer to them. Accordingly, we reject the submission on this aspect.

Finally Mr Yu referred us to the BR80/76. Notwithstanding the numbering, the decision in BR17/72 was given in November 1973 whereas that in BR80/76 was given in March 1978 but no mention is made in the latter decision of the earlier decision. It is quite clear from BR 80/76 that that Board did permit the taxpayer to adduce evidence to show that he had an honest belief that he was not liable to tax and why he had reached that conclusion. We find that decision very persuasive and quote the following passages:

> ' On the evidence before us it was submitted by counsel for the appellant that in the circumstances of this case a penalty assessment is not justified as there is 'reasonable excuse'. We agree. If the Appellant honestly believed that the sales were capital transactions this would amount to reasonable excuse since returns need not include profits or losses in transactions involving capital assets. The appellant does not understand accounts and he employs professional accountants to advise and deal with these matters. It would seem to us that reliance on the advice of an expert could also amount to reasonable excuse within the meaning of the section.'

We acknowledge that it would seem that the Revenue did not object to the introduction of that evidence and assume therefore that the correctness of allowing the evidence was not argued. However, if after the decision the Revenue did not believe that the Board should have heard the evidence, then presumably it would have appealed. In any event, we cannot see how appellants can fulfil the onus upon them to show reasonable excuse without going into the reasons why they completed their returns in the manner they did.

Accordingly, we hereby rule that Mr B will be allowed to adduce the contemporary evidence as to why he completed and filed the 1980/81 return in the way in which he did, which is to say the contemporary evidence will be admitted. He will not however be permitted to challenge the profits tax assessments.

As regards the ex post facto evidence, we cannot see that it adds anything directly to the case for Mr B because we are concerned with the circumstances prevailing at the time (26 October 1981) he filed the 1980/81 return. The best that can be said of the ex post facto evidence is that it might support his credibility on the contemporary evidence – though it might of course do the reverse. However, as we do not think that it is germane, we will not allow it to be led (except for factual matters such as the date(s) of settlement and of the profits tax assessments which are not presently known to us) and likewise we will exclude cross examination on that subject.

As we have adjourned the appeal lodged by Mr A, now deceased, technically we can make no ruling in so far as that appeal is concerned.