Case No. D47/89

Penalty tax assessment– whether sufficient for taxpayer to notify Commissioner of liability to tax – meaning of tax undercharged – section 82A of Inland Revenue Ordinance.

Panel: William Turnbull (chairman), Gillian M G Stirling and David Wu Chung Shing.

Date of hearing: 23 June 1989.
Date of decision: 11 September 1989.

The taxpayer failed to file its tax return for the year of assessment 1982/83 until October 1987. The Commissioner imposed a penalty tax assessment upon the taxpayer in the sum of $117,000. The taxpayer appealed against this assessment on the ground that it was unlawful because section 82A did not apply and alternatively that if section 82A did apply the assessment was wrong because no tax had been undercharged.

Held:

There was no substance in the submission that because the taxpayer had informed the Commissioner of its liability to tax that it had no further obligation to file a tax return under the Inland Revenue Ordinance. It was further held that there was no substance in the submission that there was no undercharge to tax.

Appeal dismissed.

Case referred to:

Dodge Knitting Company Limited and Dodge Trading Limited v CIR Inland Revenue Appeal No 8 of [1988]

G S Chadha for the Commissioner of Inland Revenue.
Cheung Yiu Hung of Y H Cheung & Co for the taxpayer.

Decision:

This is an appeal by a private limited company against an assessment to additional tax imposed upon it under section 82A of the Inland Revenue Ordinance by the Commissioner.

The facts of this case are as follows:

1. The Taxpayer was incorporated in December 1981 and commenced business as a land investment company in March 1982.

2. On 6 April 1983 a profits tax return form for the year of assessment 1982/83 was issued to the Taxpayer.

3. By a letter dated 9 June 1983 the Taxpayer, through its tax representative requested for an extension of time to 31 October 1983 for submission of the profits tax return for the year of assessment 1982/83. By a letter dated 23 June 1983 the assessor granted this request for extension. On 15 November 1983 a reminder was issued by the Inland Revenue Department to the Taxpayer.

4. By a letter dated 29 November 1983 the Taxpayer, through its tax representative requested a further extension of time to 31 December 1983 for the submission of this profits tax return. By a letter dated 8 December 1983 the assessor rejected this request for a further extension.

5. On 19 March 1984 the assessor raised an estimated assessment in the absence of return under section 59(3) of the Inland Revenue Ordinance in the amount of $100,000 for the year of assessment 1982/83. No objection was lodged by the Taxpayer against this estimated assessment.

6. On 2 April 1984 the profits tax return for the year of assessment 1983/84 was issued to the Taxpayer.

7. On 12 September 1986 the assessor raised an estimated assessment in the absence of return under section 59(3) of the Inland Revenue Ordinance in the amount of $100,000 for the year of assessment 1983/84.

8. On 1 April 1985 the profits tax return for the year of assessment 1984/85 was issued to the Taxpayer.

9. On 9 October 1986 the assessor raised an estimated assessment in the absence of return under section 59(3) of the Inland Revenue Ordinance in the amount of $100,000 for the year of assessment 1984/85. On 6 November 1986 the Taxpayer submitted its profits tax return and accounts for the year of assessment 1984/85 to validate an objection which it lodged against the estimated assessment for the year of assessment 1984/85. On 16 January 1987 the estimated assessment was revised under section 64(3) of the Inland Revenue Ordinance in accordance with the returned loss of $1,078,833.

10. On 15 December 1986 the assessor raised an additional estimated assessment in the absence of return under section 59(3) and section 60(1) of the amount of $750,000 for the year of assessment 1983/84. On 14 January 1987 the Taxpayer submitted its profits tax return and accounts for the year of assessment 1983/84 to validate an objection lodged against this additional estimated assessment for the year of assessment 1983/84. On 6 February 1987 this additional estimated assessment was revised under section 64(3) of the Inland Revenue Ordinance in accordance with the returned profit of $802,965.

11. On 30 September 1987 the assessor raised an additional estimated assessment under section 59(3) and section 60(1) of the Inland Revenue Ordinance in the amount $1,000,000 for the year of assessment 1982/83. On 27 October 1987 the Taxpayer submitted its profits tax return and accounts for the year of assessment 1982/83 to validate an objection which it lodged against this additional estimated assessment. On 18 November 1987 the additional estimated assessment was then revised under section 64(3) of the Inland Revenue Ordinance in the accordance with the returned profit of $996,612.

12. On 2 May 1988 the Deputy Commissioner gave notice to the Taxpayer that he proposed to assess additional tax on the Taxpayer by way of penalty under section 82A of the Inland Revenue Ordinance in respect of the year of assessment 1982/83.

13. On 23 May 1988 the Taxpayer through its representative made written representations to the Deputy Commissioner. On 14 June 1988 the Commissioner having taken into account these representations assessed the Taxpayer to additional tax under section 82A of the Inland Revenue Ordinance in respect of the year of assessment 1982/83 in the amount of $117,000.

14. On 13 July 1988 the Taxpayer gave notice of its appeal to the Board of Review.

At the hearing of the appeal the representative for the Taxpayer appeared before the Board and called a witness who had been the manager and a director of the Taxpayer.

The representative submitted that the penalty imposed under section 82A was unlawful. He submitted that the only initiative which a taxpayer is required to do is to inform the Commissioner that he is chargeable to tax. Once the Commissioner is aware of the fact that the taxpayer is liable to tax then it is for the Commissioner to ‘get the tax’. He submitted that all of the responsibility is put upon the Commissioner and that all that the taxpayer has to do is to act passively. He submitted that the Commissioner was not permitted in this case to impose a penalty under section 82A where the Taxpayer had failed to comply with section 51(1) of the Ordinance.

The representative went on to submit that if section 82A could apply, it is defective because it requires tax to have been ‘undercharged’. He submitted that the word

undercharged is not the same as 'not charged' or 'should have been charged'. He submitted that there must first be a charge before there can be an undercharge. He went on to argue the meaning of the words 'consequence' and 'detected' where they appear in section 82A of the Inland Revenue Ordinance to support further his submission.

With due respect to the representative for the Taxpayer we find no substance whatsoever in these submissions.

The representative then made a further legal submission based on section 59(3) of the Inland Revenue Ordinance which states that where a person has not furnished a return the assessor may estimate the amount of tax and make an assessment accordingly and then goes on to provide that 'such assessment shall not affect the liability of such person to a penalty by reason of his failure or neglect to deliver a return'. The representative drew our attention to the wording of section 82A of the Inland Revenue Ordinance which refers to the imposition of additional tax but does not made reference to such additional tax being by way of penalty. He drew our attention in contrast to the wording appearing in sections 80, 80A, 81 and 82 of the Inland Revenue Ordinance.

Although this submission may be ingenious, it finds no favour with us. Part XIV of the Inland Revenue Ordinance is headed 'Penalties and Offences'. Although the additional tax which can be imposed under section 82A is not described as a penalty, it is obvious that the imposition of such additional tax on a discretionary basis is clearly by way of penalty. The Commissioner and Deputy Commissioner are given powers under section 82A to penalise persons who without reasonable excuse fail in certain of their obligations under the Inland Revenue Ordinance. In our opinion this is quite clear and indisputable. In his reply, the representative for the Commissioner drew attention to a recent Supreme Court decision as yet unreported of Dodge Knitting Company Limited and Dodge Trading Limited v CIR, Inland Revenue Appeal No 8 of 1988. In that case the learned Judge makes reference (at page 2 of the judgment) to 'the levy of additional tax by way of penalty' when referring to the section 82A. The learned Judge then says (on the same page) 'Both taxpayer companies have been so penalised under section 82A (1)(ii) by the Commissioner'. Clearly the learned Judge had no doubt in that case that the additional tax which can be imposed under section 82A is a penalty.

Having disposed of the Taxpayer's arguments that the imposition of section 82A penalties was improper, it is now necessary to consider whether the quantum of the penalty is excessive. The representative for the Taxpayer submitted that the Taxpayer had been misled when an estimated assessment had been issued under section 59(3) and that if it was the intention to impose further additional tax under section 82A then this should have been done at the same time as the estimated assessment was issued. The representative submitted that the Taxpayer had in some way been 'trapped' by the Commissioner. The representative for the Taxpayer went on to say that the default or mistake was that of the Inland Revenue Department and not of the Taxpayer.

With due respect to the representative of the Taxpayer we find no substance in any of the submissions which he made with regard to the quantum of the additional tax imposed.

The Commissioner has been too lenient in this case. As we have not been asked by the representative of the Commissioner to increase the quantum of the additional tax assessment under section 82A it is not appropriate for us to proceed to do so. However had we been asked we would have agreed to do so. On the facts of this case we consider that an appropriate additional tax assessment under section 82A would have been in excess of the amount of the tax undercharged which was $157,246. We also find it strange that no additional assessment under section 82A appears to have been imposed upon the Taxpayer in relation to the subsequent years when the Taxpayer also failed to file tax returns in those years.

The facts of this case are amongst the worst that have come before us. The narrative of the events as they occurred speaks for itself. The Taxpayer might well have never paid tax upon the substantial profits which it made if he had not been for the detective ability of the assessor.

What happened was that the Taxpayer totally ignored its obligations to file tax returns. After having had a number of successful and profitable years during which estimated assessments were issued which were far below the Taxpayer's true profits, the Taxpayer suffered a substantial loss in its business for the year of assessment 1984/85. It received an estimated assessment for that year of assessment on profits of $100,000 and so that it could claim the loss which it had suffered and could have the estimated assessment cancelled, the Taxpayer decided that it would now file a tax return accompanied by its audited accounts. The assessor noted in those audited accounts the previous years comparative figures which disclosed profits far in excess of the estimated assessment which had been issued and paid for the previous year that is, year of assessment 1983/84. The assessor accordingly issued a substantial estimated assessment for 1983/84 based on that figure. The Taxpayer then challenged this estimated assessment and filed audited accounts for that year. These audited accounts in turn drew the attention of the assessor to the fact that the Taxpayer had again been substantially undercharged to tax in respect of that preceding year that is, 1982/83. The same procedure then occurred with a substantial estimated assessment and an objection with audited accounts for the year of assessment 1982/83. It is indeed fortunate that the assessor noted that there had been serious undercharges to tax for the years of assessment 1983/84 and 1982/83.

The Taxpayer's representative suggested that the Taxpayer could not file its tax return for the year 1982/83 because there was some doubt about its audited accounts. However no evidence was given as to why its audited accounts could not be produced on time and it is most significant that whenever it suited the purpose of the Taxpayer, it could produce audited accounts. It is also most significant that the audited accounts for the year of assessment 1982/83 were in fact dated and approved in May 1984 many years before they were ultimately submitted by the Taxpayer to the Commissioner on 27 October 1987. There

must be a suggestion, at the least, that the Taxpayer had been less than frank in handling its tax affairs.

In such circumstances we consider that the quantum of the penalty imposed is far from excessive and dismiss this appeal as having no merit whatsoever.