Case No. D66/87

Assessments – error – power to correct assessment – whether this power applies to an estimated assessment – s 70A of the Inland Revenue Ordinance.

Interpretation – principles of interpretation of tax statutes – need to avoid absurdity.

Profits tax – loss from prior year – final and conclusive assessment from prior year showing profit – whether loss deductible – ss 19(2) and 19C(4) of the Inland Revenue Ordinance.

Profits tax – loss from prior year – whether loss must be claimed in the next profitable year or may be deferred until any subsequent year – s 19C(4) of the Inland Revenue Ordinance.

Panel: H F G Hobson (chairman), Roland K C Chow and Benny Wong.

Dates of hearing: 2 and 3 February 1988.
Date of decision: 15 March 1988.

The taxpayer company made a substantial loss in its first year of business. It failed to lodge a return, and an estimated assessment showing net assessable profits of $20,000 was issued. The company paid the tax thereon and did not object, so that the assessment became final and conclusive under s 70.

In the next two years, the taxpayer made profits. The Commissioner refused to allow the loss from the first year to be deducted against those profits. The taxpayer appealed.

Held:

The loss was not deductible.

(a) It would be absurd to permit a taxpayer who had failed to make a return and who had been assessed by way of estimated assessment to resurrect prior losses indefinitely, whereas a taxpayer who had made proper returns could have its returns corrected only within six years.

(b) The power to correct errors in assessments under s 70A does not apply to estimated assessments against which no objection has been lodged.

The decision contains observations as to the timing of claims for prior years' losses.

Appeal dismissed.

Cases referred to:

D2/82, IRBRD, vol 1, 410
Canadian Eagle Oil Co Ltd v R [1946] AC 119
Cape Brandy Syndicate v IRC [1921] 1 KB 64
Carver v Duncan [1985] STC 356
Elliss v BP Oil Northern Ireland Refinery Ltd [1985] STC 722
Elliss v BP Oil Northern Ireland Refinery Ltd [1987] STC 52
Mangin v IRC [1971] AC 739
Marx v CIR [1970] MZLR 182
Sun Yau Investment Co Ltd v CIR (1984) 2 HKTC 17

Luk Nai Man for the Commissioner of Inland Revenue.
Robert Kotewall for the taxpayer.

Decision:

The circumstances giving rise to this appeal are quite straightforward – not so the question of interpretation they raise.

1. BACKGROUND

The Taxpayer company, incorporated in January 1981, commenced business on 12 June 1981, the major source of its income being rents. It made a loss in its first year 1981/82 ('1st Year') but made profits in 1982/83 ('2nd Year') and 1983/84 ('3rd Year'). It failed to respond to a notice served under s 51(1) requiring it to file a return. Accordingly on 3 February 1983 the assessor raised an estimated assessment (pursuant to s 59(3)) in the sum of $20,000 giving rise to tax of $3,300.

The Taxpayer did not invoke s 64(1) by objecting to this 1981/82 assessment: indeed it paid the $3,300.

However on 30 November 1983 the Taxpayer belatedly filed a 1981/82 return showing it had incurred losess during the 1st year. It subsequently filed returns for the 2nd and 3rd years and assessments were raised on the basis of those returns. The Taxpayer then objected (pursuant to s 64(1)) to these latter assessments because they did not take into account the large losses in the 1st year which would completely eliminate the 2nd year's assessment and substantially reduce the 3rd year's assessment. In its objections the

Taxpayer submitted that s 19(2) enables the losses to be carried forward even though they were not taken into account in the estimated assessments for the 1st year (due to the Taxpayer's failure either to submit a return for the 1st year or to object to the 1st year's estimated assessment). The then Commissioner rejected that submission because the Taxpayer 'did not for tax purposes sustain a loss' and because s 19(2) ceased to have effect after 1974/75.

The Taxpayer then appealed to this Board against that decision on the same grounds but corrected the reference to s 19(2) to read s 19C(4).

Both representatives of the Commissioner and the Taxpayer advised that it was common ground that:

(a) the 1st year losses amounted to $1,836,040 and, had the Taxpayer filed a return or taken objection timeously to the 1st year's estimated assessment, the Revenue would have allowed that amount,

(b) the 1st year's assessment is final and conclusive according to s 70,

(c) the proviso to s 70 is confined to making original or additional assessments and it cannot therefore be used to reduce or eliminate the 1st year's assessment,

(d) the errors and omissions provision contained in s 70A(1) can only be invoked where a Taxpayer has filed a return, hence as no return was filed by the Taxpayer for the 1st year that equitable provision is not open to the Taxpayer,

(e) there is no question of tax avoidance (nor mitigation since profits tax is not stepped but applies one common percentage, regardless of the extent of the profits),

(f) the word 'assess' connotes taxable profits, whilst the word 'compute' when used in reference to losses connotes a situation where the allowable losses exceed taxable profits, that is, there cannot be an assessment to losses, thus where the taxable losses exceed taxable profits no assessment arises, only a computation of the shortfall,

(g) the basis period for the 1st year's assessment is 12 June 1981 (when business commenced) to 31 March 1982.

We would add that no reason was given to the Commissioner nor was any suggested to us for the Taxpayer's failure to respond to the s 51(1) notice or to object to the 1st year's assessment.

2. RELEVANT STATUTORY PROVISIONS

We have been referred to the following sections from which we have eliminated extraneous verbiage and added emphasis (whether ours or those of the representatives).

Section 2

> 'Assessable profits' means the profits in respect of which a person is chargeable to tax for the basis period for any year of assessment calculated in accordance with the provisions of Part IV [Profits Tax].

Section 14

> Profits tax shall be charged for each year of assessment ... on every person carrying on a ... business ... in respect of his assessable profits ... for that year from ... such business ... as ascertained in accordance with this Part [Part IV, Profits Tax].

Section 19C(4)

> Where in any year of assessment a corporation ... carrying on a ... business sustains a loss in that business, the amount of that loss shall be set off against the assessable profits of the corporation ... for that year of assessment and to the extent not so set off, shall be carried forward and set off against the corporation's ... profits ... for subsequent years of assessment.

Section 19D(1)

> For the purposes of section 19C, the amount of loss incurred by a person chargeable to tax under this Part [Part IV, Profits Tax] for any year of assessment shall be computed in like manner and for such basis period as the assessable profits for that year of assessment would have been computed.

Section 70

> Where no valid objection ... has been lodged within the time limited by this Part against an assessment as regards the amount of the assessable ... profits ... the assessment as made shall be final and conclusive for all purposes of this Ordinance as regards the amount of such assessable ... profits …
>
> Provided that nothing in this Part shall prevent an assessor from making an assessment or additional assessment for any year of assessment which does not involve re-opening any matter which has been determined on objection or appeal for the year.

Mr Luk also referred us to the following sections which we do not propose to reproduce here:

s 51 (1)
s 59 (2) (a) & (b)
s 59 (3)
s 70A (1)
s 70A (2)

3. CASE LAW

3.1 The following cases were cited by Mr Kotewall:

(a) Elliss v BP Oil Northern Ireland Refinery Ltd [1985] STC 722

(b) Elliss v BP Oil Northern Ireland Refinery Ltd [1987] STC 52

(c) Mangin v IRC (1971) AC 739

(d) Carver v Duncan [1985] STC 356.

3.2 The following cases were cited by Mr Luk:

(a) Sun Yau Investment Co Ltd v CIR (1984) 2 HKTC 17

(b) D2/82, IRBRD, vol 1, 410.

4. THE TAXPAYER'S SUBMISSIONS

4.1 In a nutshell there is nothing in s 19C(4) which requires a taxpayer to claim his losses in the year in which they occur. Accordingly the Taxpayer may, if he so chooses, postpone claiming them, or any part of them, until a later year. Nor is there anything to suggest that if not so claimed they are deemed, contrary to the facts, to have ceased to exist.

4.2 S 19C(4) is enacted for the benefit of a taxpayer. It therefore follows that the word 'shall' as used in the first instance of that provision is not mandatory: it is directory – which is to say that the Revenue must allow it, if it is claimed, not that the Taxpayer must claim it.

4.3 In regard to the foregoing Mr Kotewall referred us to dicta of Walton J in the Elliss case.

In that case the Taxpayers did not wish to claim their capital and industrial building allowances for the first six years under appeal, but instead to apply them against the last four years profits (an approach which would save some sixty million pounds tax). The circumstances of that case are historically very complex: the neatest precis is to be found in the judgment of Balcombe LJ on appeal viz:

> 'The appeals raise an unusual point of statutory construction: whether for the purposes of corporation tax the capital allowances to which a company is entitled fall to be credited to the Company automatically, whether it wants them or not, or whether only those allowances which had been specifically claimed by the Company fall to be taken into account.'

The decisions turned upon whether by using the word 'shall' in the subsections (1) to (3) of s 56 of the UK Finance Act 1965 (which statute introduced corporations tax for some, but not all, companies) the legislature intended to change the long standing system applicable to individuals and companies unaffected by the new corporations tax, whereunder the choice of timing remained with the taxpayer.

4.4 Mr Kotewall referred us to various dicta of Walton J of which the following are the most in point:

(a) 'But whatever may be the nature of the allowance to which a taxpayer may be entitled, and however wide or narrow the scope of the income against which such allowance may fall to be made, it is as plain as a pikestaff that the allowance in question has been introduced as a benefit to the taxpayer and not as a benefit to the Revenue. Indeed, it is precisely for this reason that the present case is regarded, and quite rightly regarded, as paradoxical by both sides: they are for their own ends being forced to argue in a manner which quite clearly the framers of the original allowance had no cause or expect or suspect. What follows? What follows is that, the allowances in all cases being introduced for the benefit of the taxpayer, it is to be expected that the maxim quilibet potest renunciare juri pro se introducto will apply; that is to say, that a person who is entitled to a benefit of this nature, introduced for his own benefit, may take as much or as little thereof as he chooses just as he pleases: omnes licentiam habent his, quae pro se indulta sunt, renunciare.'

'Just to rub home the other side of the coin, it must equally follow that, as the allowances were most clearly not introduced for the purpose of benefiting the Revenue in any way, the Revenue can have no conceivable ground of complaint if the taxpayer does not take the fullest possible advantage thereof.'

(b) 'So much for the general background. Of course, I quite accept that these very general observations must yield to any contrary provisions contained in any Act of Parliament: that goes without saying. But what also goes without saying is that, given this background, the provisions which bring this about must be quite

clear: so fundamental a piece of background law is not to be displaced by ambiguous or doubtful words.'

(c) 'There can be no doubt at all but that the Finance Act 1965 did introduce an entirely new tax, corporation tax payable by bodies corporate.'

(d) (i) 'The construction which the Crown seeks to place on these subsections is that their application is mandatory: that is to say that it is not in any way a matter of the company claiming an allowance; if the suitable facts emerge, the capital allowances, suitably calculated, must be given effect to in full, regardless of the wishes of the taxpayer company. The reason, they say, is that there is no reference therein to the taxpayer "claiming" the allowances; instead, there is the mandatory language in sub-s (1) "there shall be made".'

(ii) 'Now, even divorced from the equation sought to be effected by s 53(1), this submission is wholly fallacious. It is fallacious precisely because it is well recongised that the use of the word "shall" in a statute may well not be, and is most frequently not, mandatory. It is in a very large number of cases directory only, and I have no doubt whatsoever but that it is in this sense that the word is used here.'

(iii) 'The most obvious reason for this conclusion is that it is totally contrary to the income tax practice, and – and I think this is the more significant reason – counsel for the Crown was totally unable to suggest any reason as to the necessity for making such a change.'

4.5 In Mangin v IRC, Lord Donovan laid down the following principles for interpretation of taxing statutes (which were adopted by Lord Diplock in the Carver v Duncan case):

First, the words are to be given their ordinary meaning. They are not to be given some other meaning simply because their object is to frustrate legitimate tax avoidance devices. As Turner J says in his (albeit dissenting) judgment in Marx v IRC [1970] NZLR 182, 208, moral precepts are not applicable to the interpretation of revenue statutes.

Secondly, 'one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used': per Rowlatt J in Cape Brandy Sydnicate v IRC [1921] 1 KB 64, 71, approved by Viscount Simons LC in Canadian Eagle Oil Co Ltd v R [1946] AC 119, 140.

Thirdly, the object of the construction of a statute being to ascertain the will of the legislature, it may be presumed that neither injustice nor absurdity was intended. If

therefore a literal interpretation would produce such a result, and the language admits of an interpretation which would avoid it, then such an interpretation may be adopted.

Fourthly, the history of an enactment and the reasons which led to it being passed may be used as an aid to its construction. [We were not referred to the history or reasons for s 19C(4).]

5. REVENUE'S SUBMISSIONS

5.1 Mr Luk's response to the Elliss decision was that it arose out of statutory provisions quite different to those in Hong Kong.

5.2 His approach therefore was to persuade us that in raising the estimated assessment the assessor must have been calculating the profits in accordance with Part IV, that is, estimated assessable income and deducted therefrom estimated allowances. Accordingly for the Taxpayer now to claim a loss is to challenge the assessor's estimate which s 70 forbids.

We cannot agree with this proposition for we fail to see how an assessor armed solely with the knowledge that the Taxpayer had commenced business (there was no evidence before us to suggest any greater intimacy) could hope to make any such calculation.

5.3 Mr Luk referred us to s 70A and the Sun Yau Investment case. However as the Taxpayer had not invoked s 70A nor could it do so because, of course, the Taxpayer filed no (timely) return to which s 70A could react, the Sun Yau Investment decision is not relevant.

5.4 Mr Luk then referred to s 19D(1) as quoted above, and went on to develop the argument that in the basis period for any year of assessment there can either be an assessable profit or a computed loss, not both. As long as an assessable profit has been determined there is no place for a loss figure for the same basis period. 'In short, in the present case [a final and conclusive estimated assessment situation] the statute does not recognize a loss for tax purpose and there is [therefore] no loss to be carried forward for set off purposes because a profit has been assessed.'

We understand this argument to mean that for tax purposes it is conclusively presumed that no loss occurred in the basis period – in much the same way that a loss not attributable to the pursuit of taxable profits is not allowable.

Mr Luk goes on to point out that losses under s 19D(1) are to be computed in like manner as assessable profits. Hence by failing to object to the assessment the Taxpayer was in effect acknowledging that there were no allowable losses for that basis period and therefore nothing can now be carried forward.

5.5 Our attention was also drawn to the words 'for all purposes of this Ordinance' in s 70 and Mr Luk submitted that these words must relate to the computation of losses for the period covered by the estimated assessment.

5.6 He summarized the Revenue's position as follows: 'When the amount of assessable profits in the basis period of a certain year of assessment has become final and conclusive in terms of section 70, the law does not recognise any loss for the same period.'

5.7 We believe that the summary is confined to estimated assessments (to which no objection has been taken) because s 70A offers a means of revising assessments to take account of omissions of losses in other forms of assessment. If we are correct in this, Mr Luk's argument that s 70 puts an end to the quantum of tax levied for any basis period is likewise limited solely to such estimated assessment situations.

5.8 Mr Luk mentions that s 59(3) is not meant to be punitive, for if it were it would be in Part XIV.

6. CONCLUSIONS

6.1 In considering the submissions we believe that account should be taken of the following aspects:

(a) The word 'profits' with reference to any given period implies that the income concerned has been reduced by the losses suffered in that period: if such losses are not taken into account the figure reflects income alone, not profits, and it would therefore be a distortion to describe the figure concerned as 'profits'. In our view therefore 'losses' are an essential ingredient in determining profits. This is probably another way of expressing Mr Luk's argument at 5.4 above.

(b) 'Assessable profits' is a defined term (s 2) but that definition does not refer to losses (for example 'profits after deduction therefrom of allowable losses'). If (a) above is correct, then it would be tautologous to do so.

(c) At first sight it would seem that, by specifically providing in s 19(1) that losses be set against assessable profits, the rationale at (a) and (b) above is not correct. However on reflection s 19(1) does not undermine (a) and (b) because that provision is not introduced simply and solely to make it clear that losses shall be set against profits. Its main purpose is to define the type of losses, that is, allowable losses (the true profits may well be less than the assessable profits because for example the taxpayer suffered undeductible losses).

S 19C(4) likewise at first sight appears to cast doubt on (a) and (b) above because it also specifically refers to losses being set off. However s 19C needs to be read as a whole to see what the legislation was driving at:

(i) S 19C(1) says the losses of an individual (who does not elect for personal assessment) shall be carried forward,

(2) is to the same intent so far as a share in a partnership is concerned,

(3) relates to the peculiarities of personal assessment;

(ii) s 19C(4) by echoing the normal approach at (a) and (b) above should therefore be seen not as superfluous but as distinguishing the treatment of corporations from those of individuals and in so doing it is necessary to reiterate the normal position.

(d) The Elliss decisions are distinguishable for the following reasons:

(i) The judges there were concerned with whether a fundamental change was intended. For our part no suggestion has been made that s 19C(4) brought about a fundamental change – at least in the sense their Lordships used that expression.

(ii) Allowances were looked upon as a 'benefit' to taxpayers. However on the reasoning of (a) above and bearing in mind that Part IV seeks to tax profits, not income, we believe that s 19C(4) does not extend any 'benefit' to the taxpayer – it merely reiterates the obvious fact that profits cannot be ascertained without taking into account losses. The only 'benefit' that is extended to taxpayers with regard to losses is the ability to carry the unabsorbed losses forward.

(iii) This last point raises the question whether the words 'subsequent years of assessment' confers a choice upon the taxpayer to leap frog (that is, bypass some profitable years then set off in a later profitable year). The words 'future years ... in succession' in s 19(2) clearly do not permit leap frogging. However as we are not confronted with leap frogging we need not decide whether the second 'shall' in s 19C(4) does confer that type of choice along with the benefit of carrying losses forward.

We therefore believe that much of the ratio decidendi in the Elliss decisions has no application in the case before us.

(e) If the Taxpayer's submission is accepted without qualification, it follows that miscreant taxpayers in the same position as the Taxpayer (that is, unappealed estimated assessments) are entitled to resurrect losses incurred many years back, whereas:

(i) those taxpayers who were merely misguided or negligent are inhibited by the 6 year rule of s 70A;

(ii) the Revenue is bound by the same rule laid down in s 60(1).

We believe that such consequences come within the 'absurdity' qualification contained in the third principle at 4.5 above and, since that principle lends itself to avoiding a literal interpretation, it must apply with greater force where a liberal interpretation is urged.

(f) Since the right of those taxpayers who are not caught by an unappealed estimated assessment is derived from s 70A we believe that, if no such statutory right is available to the miscreant taxpayer, then none was intended.

(g) Contrary to the submission at 5.8 above, s 59(3) does carry punitive elements. The Taxpayer in this case pays $26,332 in 1982/83 which it would not pay until 1983/84 and its tax in 1983/84 is $510,578 against $302,961, a difference of $233,949. However we do not think this is the type of 'injustice' referred to at 4.5 above – it is rather a direct consequence of the Taxpayer's own action or inaction.

6.2 In the light of the remarks at 6.1 we consider that the 1st year losses are conclusively presumed (an 'irrebutable presumption') not to have existed for tax purposes from the moment that the Taxpayer's right to object to the estimated assessment became time barred. Accordingly the question of the Taxpayer's right to carry them forward cannot arise.

This appeal is therefore disallowed.

We should add that the view we have formed relates to unappealed estimated expenses; we have formed no opinion as to whether leap frogging is permitted.