INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D72/95

Penalty tax – incorrect tax return – year of assessment to which the return relates.

Panel: Andrew Halkyard (chairman), Anthony J H Wood and Walter Chan Kar Lok.

Date of hearing: 25 September 1995.
Date of decision: 25 October 1995.

The taxpayer was a partnership, and submitted in previous years incorrect profits tax returns with losses overstated leading subsequently to understated tax in the year of assessment. The assessable profits for the year of assessment was materially in line with the tax return. The taxpayer claimed that no additional or penalty tax could be levied in the year of assessment under section 82A(1) of the Inland Revenue Ordinance.

Held:

Section 82A(1) do not say that an additional or penalty tax assessment under that section must relate to the year of assessment in which the incorrect return, statement or information is made or given. All the conditions necessary to support raising a section 82A assessment have been satisfied in the present case.

Appeal dismissed.

Cases referred to:

Whimster & Co v CIR [1925] 12 TC 813
D2/82, IRBRD, vol 1, 410
Elliss v BP Oil Northern Ireland Refinery Ltd [1985] STC 722
D47/90, IRBRD, vol 5, 338
D2/81, IRBRD, vol 1, 391

Chan Wan Chun for the Commissioner of Inland Revenue.
V Robert Lew of Messrs Lew and Barr for the taxpayer.

Decision:

This appeal raises a short but interesting point concerning the interpretation of section 82A(1) of the Inland Revenue Ordinance (IRO). In essence the Taxpayer contends

that, where an incorrect return has been lodged, the Commissioner of Inland Revenue only has power to raise an additional or penalty tax assessment under section 82A(1) in the year of assessment to which that return relates. This contention has specific relevance to this appeal which concerns an additional or penalty tax assessment raised in the first profit making year of assessment after overstated losses had been reported in prior years of assessment.

The facts

The relevant facts are not in dispute. They are as follows.

1. For the years of assessment 1990/91 and 1991/92 the Taxpayer submitted profits tax returns showing reported losses of $835,827 and $924,583 respectively. Following an investigation by the Inland Revenue Department ('IRD') into the taxation affairs of the Taxpayer which encompassed a period ending with the year of assessment 1991/92, the Taxpayer agreed that the losses were overstated and should have been $283,203 and $175,987 respectively. The comparative table set out below illustrates this position:

	Before Investigation Loss for the year	**After Investigation Loss for the year**	**Loss Overclaimed**
	$	**$**	**$**
1990/91	835,827	283,203	552,624
1991/92	924,583	175,987	748,596
			1,301,220

2. For the year of assessment 1992/93 the Taxpayer submitted a profits tax return showing assessable profits for that year of $1,223,183. After making certain minor technical adjustments, the assessor accepted the basis on which that return was lodged and raised a profits tax assessment for that year showing assessable profits of $1,271,277.

3. All of the proprietors of the Taxpayer, which was constituted as a partnership, elected for personal assessment for each of the years of assessment 1990/91, 1991/92 and 1992/93. For these years of assessment, each individual partner's share of the losses and profits disclosed at facts 1 and 2 was transferred by the assessor to his or her personal assessment file and tax was demanded accordingly.

4. During the course of the Board hearing, the representative for the Commissioner submitted a schedule showing that if the Taxpayer's profits tax returns for the years of assessment 1990/91 and 1991/92 had been accepted by the IRD, tax in the amount of $208,368 would have been undercharged in the year of assessment 1992/93. The Taxpayer did not object to the introduction of this schedule and accepted the figures set out therein as correct.

5. On 8 February 1995, the Commissioner gave notice under section 82A(4) informing the Taxpayer of his intention to assess additional or penalty tax for the year of assessment 1992/93 in respect of the incorrect profits tax returns lodged by the Taxpayer for the years of assessment 1990/91 and 1991/92.

6. After taking into account the Taxpayer's representations, on 29 March 1995 the Commissioner raised an additional or penalty tax assessment under section 82A on the Taxpayer in the amount of $166,000. This figure represents 79.6% of the total tax undercharged if the losses reported by the Taxpayer for the years of assessment 1990/91 and 1991/92 had been accepted by the Commissioner.

7. On 24 April 1995 the Taxpayer appealed to this Board on the grounds that:

> 'The ground of our [appeal] is that there was no tax being undercharged in the year of assessment 1992/93 based on which the additional tax could be computed and levied.
>
> … The assessable profits for the year of assessment 1992/93 being materially in line with our return is not in doubt. The Commissioner's additional tax assessment is apparently computed on the basis that [the Taxpayer] had … in the years of assessment 1990/91 and 1991/92 overstated losses, leading to the understated tax in the year of assessment 1992/93.
>
> It is our submission that the additional tax cannot be charged on overstated losses brought forward from previous years and that, having submitted a proper return for the year of assessment 1992/93, there was no undercharged tax in that particular year.'

The contentions for the Taxpayer

The Taxpayer was represented at the appeal by Mr V Robert Lew of Messrs Lew and Barr, certified public accountants ('the Representative').

Although the Representative admitted that the overstated losses for the years of assessment 1990/91 and 1991/92 eventually led to undercharged tax in the year of

assessment 1992/93, he nevertheless claimed that no additional or penalty tax could be levied in the year of assessment 1992/93. In essence, the Representative argued that section 82A(1) assessments could only be raised if tax was undercharged in *that* year for which any incorrect return, statement or information had been made or given. In the Representative's view, the present case is simply not covered by the provisions of section 82A, or any other section.

In support of his contentions, the Representative referred us to the provisions of section 14 (which states that profits tax is charged for each year in respect of assessable profits for *that year*) and section 18B(1) (which states that assessable profits for any year of assessment are computed on the full amount of profits derived *during the year of assessment*). He also referred us to Whimster & Co v CIR [1925] 12 TC 813 at 823 which held that in computing profits for tax purposes, only the profits earned for a year of assessment are subject to tax in that year and to D2/82, IRBRD, vol 1, 410 at 412 which held that an assessment is only raised and tax can only be charged where profits are derived, and not where losses are sustained. Finally, the Representative referred us to Elliss v BP Oil Northern Ireland Refinery Ltd [1985] STC 722 at 733 to support the proposition that the loss carry forward provision in section 19C(4), which was introduced for the benefit of taxpayers, should not now be used by the Commissioner as a means of penalizing the Taxpayer.

The contentions for the Commissioner

The Commissioner, who was represented by Mr Chan Wan-chun, contends that section 82A(1) does not require that the incorrect return and the undercharged tax should relate to the same year of assessment. To support his contentions, Mr Chan relied upon D47/90, IRBRD, vol 5, 338 and D2/81, IRBRD, vol 1, 391. Mr Chan notes that the Taxpayer filed incorrect returns for the years of assessment 1990/91 and 1991/92 by overclaiming losses (fact 1 refers) and, if accepted by the IRD, this would have amounted to tax being undercharged of $208,368 in the year of assessment 1992/93 (fact 4 refers). In these circumstances, Mr Chan argues that a section 82A assessment was validly raised for the year of assessment 1992/93.

Reasons for our decision

Acceptance of the Representative's contentions would, in our view, give rise to an extraordinary situation. It would mean for instance, that if a taxpayer submitted an incorrect return and overclaimed losses by say $1,000,000, with the correct losses for tax purposes being $1, no section 82A assessment could be raised on that taxpayer in subsequent years of assessment when taxable profits are derived. Conversely, if the same taxpayer had derived profits for tax purposes of $1 instead of a loss of $1, then a section 82A assessment could have been raised. However, in this latter case the additional or penalty tax could, on the basis of the Representative's contentions, only be charged in that first profit making year and then could only be computed by reference to the profits tax chargeable on the purely fortuitous level of profits derived in that year, rather than by reference to the tax which would ultimately have been undercharged if the overclaimed losses had been

accepted by the Commissioner. There seems no logic in treating these cases in such a different fashion. That is not to say that the Representative's contention must be wrong on this basis alone. But it does give us cause to consider whether that result could possibly have been the intention of the legislature given that section 19 of the Interpretation and General Clauses Ordinance (chapter 1) mandates a purposive approach to statutory interpretation by stating that an interpretation which achieves the purpose of the legislature is to be preferred to one that does not.

We agree with the Representative that, subject to a specific statutory provision to the contrary, profits tax for a year of assessment can only be levied on the profits derived in that year of assessment. The Representative then drew our attention to sections 14, 18B and 19C of the IRO. However, neither on their face nor by implication do those sections, which deal with charging and computing assessable profits for profits tax purposes, mandate that additional or penalty tax under the specific provisions of section 82A can only be levied for the year of assessment in which an incorrect return, statement or information has been made or given (see also section 82A(2)). Accordingly, the issue for our decision, that is whether the section 82A assessment was validly raised, can in the circumstances of this case only be determined by recourse to the clear words of section 82A itself.

To the extent relevant, section 82A provides as follows:

'(1) Any person who without reasonable excuse –

(a) makes an incorrect return by omitting or understating anything in respect of which he is required by this Ordinance to make a return, either on his own behalf or on behalf of another person or a partnership; or

(b) …

shall, … 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, statement or information, or would have been so undercharged if the return, statement or information had been accepted as correct; or

(ii) …

(2) Additional tax shall be payable in addition to any amount of tax payable under an assessment, or an additional assessment under section 60.'

The short answer to the Representative's contentions is that the terms of section 82A(1) simply do not say that an additional or penalty tax assessment under that section *must* relate to the year of assessment in which the incorrect return, statement or

information is made or given. Normally that would be the case but, as the facts of this case illustrate, not necessarily so. In this regard, we note it is not in dispute that:

(1) The Taxpayer made incorrect returns for the years of assessment 1990/91 and 1991/92 (fact 1); and

(2) If the Taxpayer's profits tax returns for the years of assessment 1990/91 and 1991/92 had been accepted by the IRD, tax in the amount of $208,368 would have been undercharged in the year of assessment 1992/93 (fact 4).

In these circumstances, and on the basis of the agreed facts, it seems clear to us that all the conditions necessary to support raising a section 82A assessment have been satisfied in the present case. We conclude, therefore, that the Commissioner is justified in relying upon section 82A to raise an additional or penalty tax assessment in the year of assessment 1992/93 which relates to overstatement of losses in incorrect returns for the years of assessment 1990/91 and 1991/92.

In reaching our decision we are fortified by the comments in the previous decisions D47/90, IRBRD, vol 5, 338 at 344 and D2/81, IRBRD, vol 1, 391 at 393. However, we appreciate that in neither case was the precise issue before us argued by the relevant taxpayers. In D2/81 the Commissioner raised a section 82A assessment in a loss making year in a case where the taxpayer had overclaimed losses in that year. The assessment was annulled by the Board on the basis that additional or penalty tax cannot be levied in a year where tax was in any event not payable. The Board did, however, indicate that an overstatement of losses would mean that tax would have been undercharged in the first profit making year had the return for the loss making year been accepted as correct. More significantly, in D47/90 the Board stated:

> *'Where the sum [disclosed in consequence of an incorrect return] is a negative amount that is a loss, the amount which would have been undercharged* ***has been correctly assessed*** *… as being the tax which was under assessed in [the first profit making year of assessment] based on the loss as claimed in the tax returns and which had originally been accepted by the assessor when he received the tax returns and believed them to be correct.' (emphasis added)*

For all the above reasons, we conclude that the section 82A assessment raised by the Commissioner on the Taxpayer was valid. The appeal is hereby dismissed.

It is left for us to thank both Mr Lew and Mr Chan for the clear manner in which the parties agreed upon the facts in dispute and for the structured and concise manner in which they presented this appeal before the Board.