

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D53/99

**Penalty Tax** – notice under section 82A(4) – notice of assessment and demand for additional tax – validity of notices – section 82A of the Inland Revenue Ordinance.

Panel: Ronny Wong Fook Hum SC (chairman), James Julius Bertram and David Lam Tai Wai.

Dates of hearing: 12 March and 17 May 1999.

Date of decision: 26 August 1999.

The taxpayer failed to include in his tax return certain income. A notice under section 82A(4) issued by one Mr Lee, an acting Deputy Commissioner of Inland Revenue, was sent to the taxpayer. Subsequently a Notice of Assessment and Demand for Additional Tax issued by one Mrs Sin, the Deputy Commissioner of Inland Revenue, was sent to the taxpayer demanding additional tax.

The taxpayer appealed against both liability and quantum on the ground that the two said notices were not valid as they were signed by two different persons.

#### **Held:**

- (1) The first notice was valid. The position was regulated by section 54 of the Interpretation and General Clauses Ordinance, Chapter 1. Mr Lee was lawfully discharging the functions of the Deputy Commissioner. He was appointed to act in or perform the duties of that office.
- (2) The second notice was invalid. Section 82 should not be invoked as a mere matter of routine. The initial notice proceeds on the basis that the Acting Deputy Commissioner had formed an opinion that the taxpayer had 'without reasonable excuses' made an incorrect return. If the matter is not of importance, the Legislature could simply vest the authority with an assessor. The Legislature intended the consideration of the representation of the taxpayer and the imposition of additional tax to be performed by the self same person who issued the initial notice. The Board finds it hard to accept that the taxpayer can be told that his legitimate expectation as induced by the terms of the initial notice is of no consequence. As one is dealing with penalty tax, the balance should tilt in favour of the taxpayer.

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*By the Board:* The Commissioner was invited to consider taking the matter further so as to obtain an authoritative ruling from the High Court.

### **Appeal allowed.**

Cases referred to:

D15/98, IRBRD, vol 13, 163  
D122/98, unpublished  
D133/98, IRBRD, vol 13, 619  
D50/93, IRBRD, vol 8, 369

Herbert Li instructed by Department of Justice for the Commissioner of Inland Revenue.  
Taxpayer in person.

### **Decision:**

#### **Background**

1. By a return dated 14 July 1997, the Taxpayer reported to the Revenue his income for the year of assessment 1996/97. He informed the Revenue that his total income for that year was \$149,333 being his earnings acting as senior system analyst with Company A for the period between 11 November 1996 to 31 March 1997. The Taxpayer failed to include in this return his income as analyst programmer of Company B for the period between 1 April 1996 to 7 October 1996 totalling \$218,941.
2. By an assessment dated 22 October 1997, the Taxpayer was assessed on the basis of his total income at \$326,274. This assessment was revised on 26 May 1998 to include a sum of \$10,733 in respect of the 'quarters' provided to him. The Taxpayer raised no objection against these assessments.
3. On 20 August 1998, the Revenue sent to the Taxpayer a letter ['the 1<sup>st</sup> Notice'] in these terms:

'Dear Sir,

**Notice under Section 82A(4)**  
**Inland Revenue Ordinance**  
**Salaries Tax**

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I am of the opinion that you have, without reasonable excuse, made incorrect tax return(s) for the year(s) of assessment mentioned below by omitting/understating the following income received by you:

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Year of assessment	Source	Period	Amount	Nature
1996/97	Company B	1-4-1996 - 7-10-1996	\$218,941	Salary/ Wages, leave pay, bonus
Total			<u>\$218,941</u>	

The amount of tax which has been undercharged in consequence of the incorrect return(s), or which would have been so undercharged if the return(s) had been accepted as correct is as follows:

Year of assessment	Amount
1996/97	<u>\$40,476</u>
	<u>\$40,476</u>

You are liable to be assessed under section 82A of the Inland Revenue Ordinance to additional tax of an amount not exceeding treble the aforesaid amount.

You are hereby informed that I propose to assess additional tax under this section in respect of the said incorrect return(s).

You have the right to submit written representations **to me** with regard to the proposed assessment of additional tax, which will be considered and taken into account before any assessment of additional tax is actually made. Please note that any such written representations must be received **by me** within one month from the date of this Notice.

LEE KWOK LEUNG  
Ag Deputy Commissioner of Inland Revenue

*(emphasis applied)*

4. By letter dated 18 September 1998 sent to the Commissioner of Inland Revenue for the attention of Mr Lee Kwok Leung, the Taxpayer explained that he did not obtain from Company B a copy of their employer return as promised. As time was pressing, he submitted his own return on Company B's assurance that their employer return had been sent to the Revenue. He asserted that he 'never thought of evading the tax by making false assessment.'

5. On or about 26 October 1998, the Taxpayer was sent a notice ['the 2<sup>nd</sup> Notice'] in these terms:

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‘Dear Sir/Madam/Gentleman,

**Notice of Assessment and Demand for Additional Tax**  
**Section 82A Inland Revenue Ordinance**  
Re Salaries Tax  
Year of Assessment 1996/97

With reference to the notice of 20 Aug 1998 under section 82A(4) of the Inland Revenue Ordinance (Chapter 112), after considering and taking into account representations made by you or on your behalf, I have assessed you to additional tax under section 82A of the Inland Revenue Ordinance in the sum of \$5,000 and you are now required to pay this sum on or before 7 Dec 1998 ...

Yours faithfully,

SIN LAW Yuk Lin (Mrs)

Deputy Commissioner of Inland Revenue ’

6. Section 82A(1) of the Inland Revenue Ordinance [‘the IRO’] provides:

*‘Any person who without reasonable excuse –*

*(a) makes an incorrect return ...*

*shall, if no prosecution under section 82(2) or 82(1) has been instituted in respect of the same facts, 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 ... or would have been so undercharged if the return ... had been accepted as correct ...’*

7. Section 82A(3) of the IRO provides:

*‘An assessment of additional tax may be made only by the Commissioner personally or by a deputy commissioner personally.’*

8. Section 82A(4) of the IRO provides:

*‘Before making an assessment of additional tax the Commissioner or a deputy commissioner, as the case may be, shall:*

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- (a) *cause notice to be given to the person he proposes so to assess which shall:*
  - (i) *inform such person of the alleged incorrect return ... in respect of which the Commissioner or a deputy commissioner intends to assess additional tax under subsection (1);*
  - (ii) *include a statement that such person has the right to submit written representations to him with regard to the proposed assessment on him of additional tax;*
  - (iii)...
- (b) *consider and take into account any representations which he may receive under paragraph (a) from or on behalf of a person proposed to be assessed for additional tax.'*

9. 3 issues are before us :

- (a) Is the 1<sup>st</sup> Notice valid given the fact that it was signed by an Acting Deputy Commissioner?
- (b) Is the 2<sup>nd</sup> Notice valid given the fact that it was not signed by the Acting Deputy Commissioner who signed the 1<sup>st</sup> Notice?
- (c) Is the amount of additional tax excessive?

### **Validity of the 1<sup>st</sup> Notice**

10. We accept the submissions on behalf of the Respondent (the CIR) that the position is regulated by section 54 of the Interpretation and General Clauses Ordinance (Chapter 1) which provides that :

*'In any Ordinance ... any reference to a public officer ... shall include a reference to any person for the time being lawfully discharging the functions of that office ... and any person appointed to act in or perform the duties of such office ...'*

11. Mr Lee Kwok Leung was lawfully discharging the functions of the Deputy Commissioner. He was appointed to act in or perform the duties of that office. We accept therefore that the 1<sup>st</sup> Notice is valid.

### **Validity of the 2<sup>nd</sup> Notice**

12. Section 82A(4) entails compliance with the following 'chronological' steps prior to the imposition of additional tax:

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- (a) The submission by the taxpayer of an incorrect return.
- (b) The forming of an intention on the part of the Commissioner or a deputy commissioner to assess additional tax in respect of such incorrect return.
- (c) The despatch of a notice in compliance with the specific requirements to the taxpayer in question.
- (d) The consideration by the Commissioner or a deputy commissioner of the representations from the taxpayer in question.
- (e) The imposition of additional tax by the Commissioner personally or a deputy commissioner personally.

13. The issue is whether the officer who performs steps (d) and (e) must be the same officer who performed steps (b) and (c). There are 2 separate lines of authorities.

14. The first line of authorities can be found in D15/98, IRBRD, vol 13, 163 and D122/98 (unpublished). It proceeds on the basis that on a proper construction of section 82A(4), steps (b) to (e) have to be performed by the same person. Given the normal canon of construction applicable to a tax statute, no additional tax can properly be imposed if steps (b) and (c) on the one hand and steps (d) and (e) on the other hand are performed by different officers.

15. The second line of authorities is represented by D133/98, IRBRD, vol 13, 619. It assumes that a proper construction of section 82A(4) does require performance of steps (b) to (e) by the self same officer. It distinguishes the first line of authority on the basis that the consequence of non-compliance is not material and does not invalidate the assessment of additional tax.

16. We have subjected both lines of authorities to close scrutiny. With respect, we prefer to follow the first line of authorities for the following reasons:

- (a) The Board in D133/98 took the view that ‘whether to issue notices and causing issue of the notice itself are almost routinely carried out as a matter of course’ [see paragraph 14] and that ‘the taxpayer’s protection is that the assessment of additional (penalty) tax may only be done by the personal action of the Commissioner or his deputy’ [see paragraph 15]. We are of the view that section 82A should not be invoked as mere matter of routine. The 1<sup>st</sup> Notice proceeds on the basis that the Acting Deputy Commissioner had formed an opinion that the Taxpayer had ‘without reasonable excuse’ made an incorrect return. This initial notice should not be issued as a matter of course. The legislature intended steps (b) and (c) to be performed by the Commissioner or a deputy commissioner. If the matter is

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not of importance, the Legislature could simply vest the authority with an assessor.

- (b) The Board in D133/98 sought to compare section 82A with the court procedure under sections 80 and 82 of the IRO. The Board thought that steps (d) and (e) are analogous to steps (iv) to (vi) of the court procedure. ‘The question we have to ask is that if the different functions are carried out by two different persons – one is to decide the prima facie case and the other is to decide the verdict and sentence, will the defendant be prejudiced? In normal criminal cases the answer is a definite affirmative “yes” [see paragraph 14]. On the other hand, the Board concluded that non compliance with section 82A can cause no injustice or unfairness to the taxpayer. The Board did not explain what are the policy considerations that dictate the affirmative answer in the normal criminal cases and why those considerations are inapplicable to section 82A. Given their hypothesis that the Legislature intended (b) to (e) to be performed by the self same person, why shouldn’t the Legislature be presumed to incorporate the safeguards in normal criminal cases into the process of exacting penalty tax? A Judge who decides on the existence of a prima facie case might have attached various weight to divers factors in coming to that conclusion. The self same Judge should decide on the verdict in order to ensure consistency in the weighing process. The Legislature intended the taxpayer to have this consistency of treatment. His position is prejudiced if the initial and subsequent notices are considered by different officers.
- (c) The current level of penalty tax is high and sometimes ruinous. The recipient of the initial notice is notified in terms that a particular officer had formed an opinion that he had transgressed without reasonable excuse and that his representations would be considered by the self same officer. The drafting of this initial notice is no doubt reflective of what the Revenue regards as the proper construction of the section. We find it hard to accept that the taxpayer can then be told that his legitimate expectation as induced by the terms of the initial notice is of no consequence.
- (d) One is dealing with penalty tax. The balance should tilt in favour of the taxpayer. We prefer to adopt a construction so as to confer on the taxpayer additional protection. We reject the opposing construction which recognises the requirement that (b) to (e) have to be considered by the same person but treats the same as nugatory.

17. For these reasons we hold the 2<sup>nd</sup> Notice invalid and the consequence of its invalidity is that the additional tax cannot be exacted.

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### **The third issue – quantum**

18. If we be wrong on the second issue, we would not have disturbed the assessment. We have in mind the decision of this Board in D50/93, IRBRD, vol 8, 369. In that case the taxpayer was a Japanese national who filed an incorrect salaries tax return omitting part of her income. She submitted she should not be penalized under section 82A because she was unfamiliar with Chinese or English and did not understand Hong Kong taxation. The Board there held that illiteracy or ignorance is not excuse and likewise linguistic difficulties are no excuse. The Board upheld a penalty which was equivalent to about 10% of the tax undercharged.

19. The Taxpayer raised the same arguments before us. We are of the view that D50/93 is directly applicable. If the 2<sup>nd</sup> Notice be valid, we would have confirmed the assessment.

### **Our decision**

20. We allow the appeal and set aside the assessment.

21. We apologise for the delay in arriving at our decision. We have considered the issue with great anxiety given the cogency of the decision in D133/98.

22. There are many similar cases before this Board. We would therefore invite the Respondent (the CIR) to consider taking this matter further so as to obtain an authoritative ruling from the High Court.