

INLAND REVENUE BOARD OF REVIEW DECISIONS

**Case No. D138/02**

**Penalty tax** – failure to report part of income – reasonable excuse.

Panel: Ronny Tong Ka Wah SC (chairman), Krishnan Arjunan and Peter Ngai Kwok Hung.

Date of hearing: 22 January 2003.

Date of decision: 20 March 2003.

During the relevant year of assessment, the taxpayer's employment as a company director was terminated. He received a cheque of about £20,000 for the year under a somewhat unusual compensation scheme. However, he failed to include the sum in his tax return.

As a result, a penalty of \$3,800, which is about 10% of the amount of tax undercharged, was imposed upon him.

The taxpayer explained that it was only an oversight not to include this sum in his tax return.

**Held:**

The Board found that mere oversight could not constitute reasonable excuse. Nevertheless, the Board found that \$2,000 would have reflected the circumstances of the case and so ordered.

**Appeal allowed in part.**

Cases referred to:

D112/97, IRBRD, vol 13, 31

D115/01, IRBRD, vol 16, 893

D76/99, IRBRD, vol 14, 525

Li Mei On for the Commissioner of Inland Revenue.

Taxpayer in person.

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### **Decision:**

### **Background facts**

1. This is an appeal against a penalty tax raised on the Taxpayer under section 82A of the Inland Revenue Ordinance ('IRO') for the year of assessment 2000/01.
2. The facts are not in dispute. They are these. The Taxpayer changed employment during the relevant year of assessment. His employment as a director of Company A was terminated on 2 May 2000. He joined his new employer, Company B on 1 June 2000.
3. Company A was a subsidiary of a listed London company. The Taxpayer's remuneration structure was somewhat unusual. In addition to the salary and the usual allowances and bonuses, it included a deferred share compensation scheme ('the Scheme'). The Scheme was managed in London. According to the Taxpayer, at the end of each London tax year, he would be informed as to whether, and if so, how much, compensation he would receive under the Scheme. He was thus unable to foresee how much, if any, entitlement under the Scheme would be made available to him upon his departure from Company A.
4. The Taxpayer received a cheque in the amount of £20,685.6 in July or August 2000 from Company A. The Taxpayer claimed he did not notice the significance of this cheque as he received a number of cheques on salary, gratuity payments and pension payments over this period.
5. In September 2000, the Taxpayer received a copy of a tax return ('Form IR56F') from his employer, Company A, which set out all his emoluments save that it omitted to make reference to the Taxpayer's entitlements, if any, under the Scheme.
6. The Taxpayer made his tax return dated 31 May 2001 based on the information set out in Form IR56F together with information he received in a similar way from Company B. The Taxpayer was taxed accordingly based on his return.
7. The Revenue was eventually notified by Company A of the taxable income of £20,685.6 (the equivalent of \$253,581) being gain realized by the exercise of share option under the Scheme. We were not informed as to the date when the Revenue became aware of the payment of this sum.
8. By reason of the omission of income in the sum of \$253,581 from the return, the Commissioner imposed a penalty of \$3,800 which is roughly about 1.5% of the income omitted and 10% of the amount of tax undercharged.

### **The law**

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9. The material part of section 82A(1) of the IRO reads:

*‘(1) Any person who without reasonable excuse –*

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

*(b) makes an incorrect statement ...; or*

*(c) gives any incorrect information in relation to any matter or thing affecting his own liability to tax ...*

*...*

*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 ...’*

10. Plainly, the burden is on a taxpayer to make a correct return. As is stated in the guidelines, the effective operation of Hong Kong’s simple tax system demands a high degree of compliance by taxpayers. In this respect, mere oversight or carelessness cannot in any view constitute ‘reasonable excuse’. Such conduct is not conducive to the efficient operation of our tax system nor is it fair to the community at large. It follows that in order to be excused, the taxpayer must show a reasonable explanation other than mere oversight or carelessness.

### **The Taxpayer’s case**

11. The Taxpayer’s case is that he had absolutely no say on how the Scheme operated. Nor was he in any position to bring about the payment or to determine what sum was payable to him. But he knew that there was at least a possibility, to put it at the very lowest, that he would receive something under the Scheme.

12. The Taxpayer claimed he was misled by Company A’s Form IR56F which omitted any reference to payment under the Scheme. Looking at the document, we could see that an employee might well be misled since it disclosed a detailed breakdown of various payments made or to be made to the employee but there was no figure inserted against paragraph 13(h) thereof which referred to the Scheme.

13. But the matter does not stop there. The Taxpayer admitted that first, the sum £20,685.6 was not a small sum; secondly, the payment must have arrived together with a covering

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note which identified the payment as one under the Scheme; thirdly and most importantly, the cheque was received well before he made his tax return. The Taxpayer claimed he might be away from Hong Kong at the time but wherever he might be at the time the cheque came through the mail, he must be in a position to find out what this sum was all about. If someone had paid in the cheque for him, that someone must be obliged to inform the Taxpayer what was the reason why he was entitled to receive such a sum.

14. Has the Taxpayer a reasonable excuse in filing an incorrect tax return? We think not. At the very least, the Taxpayer had failed in his duty to investigate precisely what payments were received by him during the relevant year of assessment which he must report to the Revenue.

### **Whether amount excessive**

15. This is, however, not to say, there are no mitigating circumstances.

16. The Revenue cited the case D112/97, IRBRD, vol 13, 31. But that was a case where there was a finding of 'a high degree of carelessness indicative of a cavalier attitude'. In that case, a penalty of 21.04% of the tax undercharged was confirmed by the Board.

17. In D115/01, IRBRD, vol 16, 893, a differently constituted Board held that a starting point for considering any penalty is 10% where no dishonesty or recklessness was found.

18. In D76/99, IRBRD, vol 14, 525, yet another differently constituted Board found that there were mitigating factors in that case and the fine was reduced by half.

19. In the present case, it was not challenged that Company A's Form IR56F was misleading. We accept there was no dishonesty on the part of the Taxpayer and as far as we are aware, this is his first lapse in attending his tax affairs. We think a reduction from \$3,800 to \$2,000 would be a fair reflection of the circumstances and we so order.