

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D138/99

Penalty Tax – income was understated in two years of assessment – reliance placed upon his employer's return for full compliance of his obligation – absence of an intention to understate any income – personal circumstances not a reasonable excuse for omission – whether long absence from Hong Kong is a reasonable excuse for the omission or understatement – whether penalty at the rate of 15% under section 82A of Inland Revenue Ordinance ('IRO') excessive.

Panel: Andrew Halkyard (chairman), Michael Neale Somerville and William Zao Sing Tsun.

Date of hearing: 13 January 2000.

Date of decision: 15 March 2000.

The taxpayer was found to have submitted incorrect profits tax returns for the two years of assessment 1991/92 and 1992/93 and the tax returns for individuals for the two years of assessment 1993/94 to 1995/96 in respect of the business carried out in the name of Company X. The amount of profits understated was \$799,072 and the tax undercharged was \$171,455.

The Commissioner was of the opinion that the taxpayer had submitted incorrect tax returns without reasonable excuse. After considering the taxpayer's written representations, the Commissioner imposed additional tax by way of penalty in the amount of \$183,000, which represented 106.7% of the tax undercharged. The taxpayer appealed under section 82B of the IRO against these additional or penalty tax assessments on the ground that they were excessive.

Held :

1. The argument that the penalty tax was excessive because the additional profits assessed were excessive, should be rejected : D45/90, IRBRD, vol 5, 336.
2. By reason of the fact that when the taxpayer agreed the additional profits tax assessments, and at all relevant times thereafter, the current tax representative was advising and representing the taxpayer, the argument that the taxpayer relied upon and was misled by the advice of his first tax representative, should be rejected.
3. The personal circumstances of the taxpayer did not constitute a reasonable excuse for failure to lodge correct tax returns but could be relevant to the quantum of penalty tax.

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4. Where a taxpayer has failed to keep proper accounts and file correct tax returns, as a general rule the penalty should be equal to the amount of tax undercharged, namely, 100% : D4/89, IRBRD, vol 4,172.
5. On the basis of the facts found and all the circumstances referred to the Board, and given that there appears to be an element of doubt as to the inadequacy of the taxpayer' s accounting records, the Board decided that a discount from the normal 100% penalty tax referred to in D4/89 was appropriate in this case. It was ordered that for each year of assessment under appeal the additional or penalty tax charged should be reduced uniformly to 85% of the tax undercharged for that relevant year.

Appeal allowed in part.

Cases referred to:

D45/90, IRBRD, vol 5, 336

D4/89, IRBRD, vol 4, 172

Pong Shu Wing for the Commissioner of Inland Revenue.
Taxpayer in person and represented by his representative.

Decision:

1. This is an appeal under section 82B of the Inland Revenue Ordinance against additional or penalty tax assessments raised on the Taxpayer for the years of assessment 1991/92 to 1995/96 inclusive.

The facts

2. The agreed facts, which we so find, are set out in a document produced to us entitled ' statement of facts' . No further evidence was introduced in the hearing before us, although the Taxpayer read to us a prepared statement that we refer to below.

3. As a result of an investigation carried out by the Inland Revenue Department (' IRD'), the Taxpayer was found to have submitted incorrect profits tax returns for the years of assessment 1991/92 and 1992/93 and tax returns for individuals for the years of assessment 1993/94 to 1995/96 in respect of the business carried out in the name of Company X (' the Business'). The amount of profits understated was \$799,072 and the tax that would have been undercharged if the tax returns were accepted as correct was \$171,455.

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4. The Commissioner was of the opinion that the Taxpayer had submitted incorrect tax returns without reasonable excuse. After considering the Taxpayer's representations, the Commissioner imposed additional tax by way of penalty in the amount of \$183,000. This amount represented 106.7% of the tax undercharged. In this appeal the Taxpayer claims that these additional or penalty tax assessments are excessive.

The Taxpayer's contentions

5. As indicated above, the Taxpayer did not give oral evidence before us. However, both he and his tax representative, Mr Lau Kam-shun, presented various arguments to support the claim that the penalty tax assessed should be reduced.

6. These arguments can conveniently be grouped under the following categories:

1. The additional profits on which the penalty tax was based were overstated

Various matters were raised including the claim that the Taxpayer's daughter had at all relevant times worked in the Business and been paid a salary of some \$6,000 to \$7,000 per month. It was claimed that none of this amount had been taken into account in determining the additional profits assessed. It was also contended that the Business was a small family concern and the turnover for the Business could not have justified the level of additional profits assessed.

2. The advice given to the Taxpayer by his first tax representative was wrong

The first tax representative (fact 4 refers) advised the Taxpayer that the amount of salary paid to his daughter was not an allowable deduction from the profits of the Business. On this advice the Taxpayer agreed to accept the assessor's method of determining additional profits derived by the Business based upon a gross profit ratio computed by the assessor (compare fact 10).

3. The Taxpayer was co-operative with the IRD throughout the investigation

Mr Lau claims that once he started to assist the Taxpayer during the investigation, it was completed within three months. The Taxpayer also noted that the profits for the final year of assessment covered by the investigation, 1996/97, for which it appears no penalty tax was levied, were based upon his accounts for the Business and that these had proved satisfactory to the assessor. By way of contrast, the Business' records and accounts were destroyed by a flood in May/June 1995 (compare fact 6). This circumstance contributed to the Taxpayer's agreeing the additional profits tax assessments.

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4. The Taxpayer's personal circumstances

Various claims were put to us that the Taxpayer was in dire financial straits and simply could not afford to pay the penalty tax assessed and, in any event, could only pay by instalments. It was also put to us that in recent years the Taxpayer had suffered serious health problems, including several chronic diseases, that he was an old man (70 years old), that he now had no regular income after retiring from the Business and that he had two young school-age children.

Our analysis

7. We agree with the Commissioner's representative, Mr Pong Shu-wing, that we should reject the Taxpayer's first argument that the penalty tax was excessive because the additional profits assessed were excessive. In this regard, we need simply state that we agree with the decision of a previous Board of Review which stated in D45/90, IRBRD, vol 5, 336:

' It is common for taxpayers to submit that penalties are excessive because they consider the assets betterment statement to be incorrect. It is always necessary for this Board in such cases to point out to the taxpayer that once assessments have become final, they are final and conclusive for all purposes of the Ordinance including section 82A penalties.'

8. Similarly, we agree with Mr Pong that we should reject the Taxpayer's second argument that the Taxpayer relied upon and was misled by the advice of the first tax representative. In this regard, we need simply note that when the Taxpayer agreed the additional profits tax assessments, and at all relevant times thereafter, the current tax representative, Mr Lau, was advising and representing the Taxpayer (facts 9 and 10 refer).

9. In so far as the Taxpayer's personal circumstances are concerned, we also agree with Mr Pong that they do not constitute a reasonable excuse for failure to lodge correct tax returns. However, they can be relevant to the quantum of penalty tax. As will be shown below, we have considered these circumstances in the context of whether the penalty tax assessed was excessive having regard to the circumstances.

10. We now turn to those personal circumstances. On the facts before us we are simply in no position to give a definitive ruling upon the Taxpayer's financial circumstances and therefore his ability to pay any additional tax. Although the Taxpayer referred to this matter in his prepared statement, there is insufficient evidence before us to make such a finding. We do find, however, from his demeanour before us, that the Taxpayer is clearly not a well man. It may be a slight exaggeration but he presents a picture of someone whose world has, in many ways, fallen apart.

11. Finally, and perhaps most importantly, we find that there is some doubt upon the extent to which the Taxpayer kept proper books and records for the Business. We base this

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observation upon the fact that the profits for the final year of assessment under investigation, 1996/97, for which it appears that no penalty tax was levied, were based upon his accounts and records for the Business. These accounts and records apparently proved satisfactory to the assessor. In this regard, the Taxpayer also claimed that certain records of the Business for earlier years were destroyed by a flood in 1995. Mr Pong did not challenge this. Nevertheless, it was part of the Commissioner's case that the Taxpayer did not keep proper accounting records. The Commissioner in imposing the penalty tax under appeal apparently considered this matter.

12. When we questioned Mr Pong on the matter of the Business' records, he very properly stated that apart from a change in the nature of Business in the year of assessment 1994/95 (when a new commodity was sold, extra records were kept, and thus the totality of those records could be considered somewhat more reliable than those kept for earlier years), he could not state categorically that the earlier records were any worse from the IRD perspective than those kept in the year of assessment 1996/97. Mr Pong also properly acknowledged that at all relevant times the Taxpayer co-operated with the IRD during the investigation. On the other hand, we note that the Taxpayer had destroyed various primary records when the account book entries had been made (fact 5 refers). We note that this may have prejudiced the IRD during the conduct of its investigation.

13. In D 4/89, IRBRD, vol 4, 172 the Board of Review stated that:

' Where a taxpayer has failed to keep proper accounts and file correct tax returns, as a general rule the penalty should be equal to the amount of tax undercharged [namely, 100%].'

14. On the basis of the facts found and all the circumstances referred to above, and given that there appears to be an element of doubt as to the inadequacy of the Taxpayer's accounting records, we have decided that a discount from the normal 100% penalty tax referred to in D 4/89 is appropriate in this case. We therefore order that for each year of assessment under appeal the additional or penalty tax charged should be reduced uniformly to 85% of the tax undercharged for that year.