Case No. D14/99

Penalty Tax – failure to include in tax return a sizable taxable gratuity – no reasonable excuse – penalty not excessive – Inland Revenue Ordinance, Chapter 112, section 82A.

Panel: Andrew Halkyard (chairman), Sydney Leong Siu Wing and William Tsui Hing Chuen.

Date of hearing: 6 May 1999.
Date of decision: 25 May 1999.

The taxpayer failed to include in his tax return a taxable gratuity of $225,000 which amounted to more than 25% of his taxable income. The Commissioner imposed penalty tax on the taxpayer of some 20% of the tax that would have been avoided if the taxpayer's tax return were accepted as correct.

The taxpayer appealed against the Commissioner's determination on the grounds that (1) he was under stress, being very busy at work, undertaking postgraduate studies, experiencing some marital problems; (2) when he on 25 May 1998 phoned to ask the assessor whether he should elect for personal assessment, the assessor misled him by telling him that he had some $600,000 taxable income, though at the time of his phone conversation with the assessor the taxpayer had received his copy of the employer's return correctly showing the amount of the gratuity. He did not, however, correct the assessor's statement that he only earned 'some $600,000' from his employment; neither did he check with his employer to see if the employer had made a mistake in its employer's return; (3) as the gratuity was paid to him early in the year of assessment (April 1997), he was confused as to the appropriate year in which the amount should be assessed; (4) he had no intention to avoid payment of tax. In any event, the IRD would always assess any taxable income derived by his because it would be in receipt of the employer's return disclosing the amount of any gratuity paid to him; (5) the action taken by the IRD in assessing penalty tax some three months after assessing his salaries tax liability was unfair.

Held:

1. On the evidence there was no reasonable excuse whatsoever for the taxpayer to fail to include the gratuity that amounted to more than 25% of his taxable income in his tax return. As the taxpayer was well aware of his taxable income at the time when he phoned the assessor, there was no ground in alleging that he has been misled by the assessor.

2. The Board also rejected the taxpayer's claim that he was confused as to the appropriate year in which the amount should be assessed. The amount of the gratuity was paid to him in the first month of the year of assessment (April 1997). This was an annual payment. It had been properly dealt with both by the taxpayer and his employer in at least the two previous years. There was no reason for the taxpayer to suggest why the gratuity paid in the year of assessment 1997/98 should be taxed any differently than previously.

3. The taxpayer's actions in this case indicate a high lack of both care and concern as to whether his tax return was correct or incorrect. In all the circumstances, and notwithstanding the taxpayer's protestations of good faith and suffering from stress, the Board was not satisfied that the Commissioner's assessment was excessive.

4. Finally, the Board considered the taxpayer's argument that the action taken by the IRD in assessing penalty tax some three months after assessing his salaries tax liability was unfair has no merit. Penalty tax is an entirely separate issue from that of the normal assessment to salaries tax. It can only be imposed personally by the Commissioner or a Deputy Commissioner, and then only after the taxpayer is given an opportunity to explain his actions and the surrounding circumstances, which in this case involved failure to declare taxable income. All this was properly done in accordance with the relevant provisions of the IRO, section 82A.

Appeal dismissed.

Chow Tai Chin Hing for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

1. This is an appeal by the Taxpayer against an additional or penalty tax assessment raised on him for the year of assessment 1997/98. The basic facts, which we so find, are set out in the document produced to us headed 'statement of facts'. In short, the appeal relates to penalty tax imposed upon the Taxpayer for failing to include in his tax return a taxable gratuity of $225,000.

Proceedings before the Board

2. The Taxpayer elected to give sworn evidence before us. On the basis of that evidence, and the documents placed before us by the parties, we find the following additional facts.

1. The Taxpayer's employer submitted the employer's return for the year of assessment 1997/98 in respect of the Taxpayer to the IRD in the following way. First, it was submitted electronically. This electronic submission did not disclose payment of the Taxpayer's gratuity that was received and banked by him in April 1997. Second, a hard copy was sent to the IRD. This hard copy did disclose details of the gratuity. The disclosure took the form of a hand-written annotation on the employer's return that for the year ended 31 March 1998 the Taxpayer received a gratuity of '$225,000'. Each version of the employer's return was received by the IRD on 23 April 1998.

2. In previous years of assessment 1995/96 and 1996/97 the employer's returns also set out details of the Taxpayer's gratuity, an amount paid annually by the employer. In each case, the hand-written annotation was in the same form as that contained in the hard copy of the employer's return for the year of assessment 1997/98 described at fact 1. In these years of assessment, the Taxpayer relied upon the figures contained in the employer's returns and properly included in his tax returns the full amount of his income from employment, including the gratuity. In this regard, the Taxpayer admitted that he was aware of the facts that these payments of gratuity were properly recorded in the employer's returns, properly recorded by him in his tax returns, and properly assessed by the assessor.

3. Approximately ten days before filing his tax return (on 25 May 1998), the Taxpayer phoned the assessor. His purpose was to ask the assessor whether he should elect for personal assessment. In the words of the Taxpayer 'I phoned [the IRD in May 1998] because I wanted to see if I could save tax through personal assessment'. At no time during this conversation did the Taxpayer inform the assessor of the amount of his taxable income from his employment. However, during the course of the conversation, the assessor, having checked the IRD records, told the Taxpayer that because he earned 'some $600,000'[1] of taxable income it would be appropriate for him to elect for personal assessment. We infer from this fact that the assessor made this statement after accessing the electronic filing of the employer's return, but not the hard copy that disclosed the additional amount of the gratuity (fact 2 refers).

4. At the time of his phone conversation with the assessor (fact 3 refers) the Taxpayer had received his copy of the employer's return correctly showing the amount of the gratuity. He did not, however, correct the assessor's statement that he only earned 'some $600,000' from his

[1] This amount represents, in very round figures, the Taxpayer's taxable emoluments for the year of assessment 1997/98 from his employment - but excluding the gratuity.

employment; neither did he check with his employer to see if the employer had made a mistake in its employer's return. He simply accepted the assessor's statement at face value.

5. At the time he completed his tax return in May 1998, the Taxpayer stated that he was under stress, being very busy at work, undertaking postgraduate studies and experiencing some marital problems.

Arguments for the Taxpayer

3. At the Board hearing the Taxpayer argued, on the basis of the evidence he gave to us, that:

1. Although he agreed that he made a mistake in filling out his tax return, he was misled by the IRD and should therefore be excused from filing a correct return. He also indicated that because the gratuity was paid to him early in the year of assessment (April 1997), he was confused as to the appropriate year in which the amount should be assessed.

2. He had no intention to avoid payment of tax. In any event, the IRD would always assess any taxable income derived by him because it would be in receipt of the employer's return disclosing the amount of any gratuity paid to him. In this regard, the Taxpayer indicated that he thought that if the gratuity were not assessed in the year of assessment 1997/98, then it would surely be assessed in the following year.

3. The action taken by the IRD in assessing penalty tax some three months after assessing his salaries tax liability was unfair. Penalty tax should have been imposed at the same time that his assessment for salaries tax was issued.

Arguments for the Commissioner

4. On the basis of her cross-examination of the Taxpayer and a written submission handed to us, the Commissioner's representative, Mrs Chow Tai Chin-hing, defended the penalty tax assessment. In light of our view of the Taxpayer's evidence, it is not necessary for us to comment upon this submission in detail. Suffice to say that Mrs Chow forcefully argued that the Taxpayer had no reasonable excuse for omitting his gratuity from his tax return and that, in all the circumstances, the penalty tax assessed was not excessive.

5. We should add that Mrs Chow properly admitted the possibility that the assessor had only accessed the electronic filing (and not the hard copy) of the employer's return when speaking with the Taxpayer on the telephone (fact 3 refers). Indeed, Mrs Chow did not dispute the Taxpayer's evidence relating to this telephone conversation.

Reasons for our decision

6. On the evidence before us and the facts found, we can see no reasonable excuse whatsoever for the Taxpayer failing to include the gratuity in his tax return. We accept the Taxpayer's version of his telephone conversation with the assessor (fact 3 refers) but, as he admitted in evidence, the purpose of this conversation was not directed in any way to ascertaining the correct amount of his taxable income. Indeed, at the time of this conversation, the Taxpayer was fully aware of the correct amount of his taxable income, having received a complete and correct copy of the employer's return (fact 4). The form of this return, including details of his annual gratuity, was in precisely the same terms as the returns for the two previous years which he had relied upon to properly complete and file his own tax returns (fact 2).

7. We therefore reject the Taxpayer's claim that he was misled by the assessor to file a correct tax return. We also reject the Taxpayer's claim that he was confused as to the appropriate year in which the amount should be assessed. The amount of the gratuity was paid to him in the first month of the year of assessment (April 1997). This was an annual payment. It had been properly dealt with both by the Taxpayer and his employer in at least the two previous years. We can see no reason, nor was the Taxpayer able to suggest any, why the gratuity paid the year of assessment in 1997/98 should be taxed any differently than previously.

8. The real flavour of the Taxpayer's actions was brought out in cross-examination dealing with his phone conversation with the assessor (fact 3 refers). Specifically, it was put to the Taxpayer that the written annotation showing the gratuity paid to him was entered in the same way on each of the employer's returns for the years of assessment 1995/96 to 1997/98 inclusive. The Taxpayer agreed. The Taxpayer then acknowledged that he had a copy of the employer's return when he spoke with the assessor and that this copy correctly set out details of the gratuity. It was then put to the Taxpayer that, assuming the assessor had accessed the electronic filing only when referring to his income as '$600,000 something', he thought the IRD did not have the details of the gratuity and he thus purposely excluded it. In his answer the Taxpayer did not deny this implication; rather, he merely stated that he knew that the gratuity would then be taxed in the following year and that he was under stress.

9. In all the circumstances, we agree with Mrs Chow who summarised the Taxpayer's actions in this way: '[Following his conversation with the assessor] he turned a correct employer's return into an incorrect employer's return'. He did this without checking with the IRD or with his employer. This is in no way the action of a person who has a reasonable excuse for omitting from his tax return a gratuity that amounted to more that 25% of his taxable income.

10. The Commissioner imposed penalty tax on the Taxpayer of some 20% of the tax that would have been avoided if the Taxpayer's tax return were accepted as correct. It is not to the point to state that the IRD has assessed the correct amount of salaries tax. What is in

point is the Taxpayer's omission without reasonable excuse of a substantial amount of his taxable income. In our view, the Taxpayer's actions in this case, at best, indicate a high lack of both care and concern as to whether his tax return was correct or incorrect. In all the circumstances, and notwithstanding the Taxpayer's protestations of good faith and suffering from stress, we are not satisfied that the Commissioner's assessment was excessive.

11. Finally, we note the Taxpayer's argument that the action taken by the IRD in assessing penalty tax some three months after assessing his salaries tax liability was unfair. This argument has no merit whatsoever. Penalty tax is an entirely separate issue from that of the normal assessment to salaries tax. It can only be imposed personally by the Commissioner or a Deputy Commissioner, and then only after the Taxpayer is given an opportunity to explain his actions and the surrounding circumstances, which in this case involved failure to declare taxable income. All this was properly done in accordance with the relevant provisions of the Inland Revenue Ordinance, section 82A.

12. For all the above reasons this appeal is dismissed.