

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D168/01

Penalty tax – understating income – whether penalty excessive.

Panel: Patrick Fung Pak Tung SC (chairman), Paul Shieh Wing Tai and Peter Sit Kien Ping.

Date of hearing: 19 November 2001.

Date of decision: 20 March 2002.

The taxpayer was investigated for understating his income. As a result, the taxpayer agreed that he failed to report about 25% of his assessable income. Additional tax of about 110% over the undercharged tax was assessed against him.

The taxpayer appealed against the assessment as being excessive.

Held:

1. The Board found the taxpayer had no reasonable excuse in understating his income.
2. The standard practice is to adopt as a starting point penalty equivalent to 100% of the tax underpaid while the maximum is 300%.
3. Having considered that, inter alia, the taxpayer did not adopt a co-operative attitude towards the Inland Revenue Department ('IRD'), the Board did not find the penalty excessive.

Appeal dismissed.

Cases referred to:

D65/00, IRBRD, vol 15, 610

D179/98, IRBRD, vol 14, 78

D71/91, IRBRD, vol 7, 1

D52/93, IRBRD, vol 8, 372

Tsoi Chi Yi for the Commissioner of Inland Revenue.

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Taxpayer in person.

Decision:

1. This is an appeal by the Appellant (' the Taxpayer') against an assessment for additional tax under section 82A of the Inland Revenue Ordinance (' IRO') by the Respondent (' the Commissioner').

2. The additional tax assessed and demanded are contained in six notices of assessment and demand all dated 30 July 2001 and are in relation to the following years of assessment:

	\$
(a) 1990/91	9,700
(b) 1991/92	8,400
(c) 1992/93	28,300
(d) 1993/94	33,500
(e) 1994/95	4,500
(f) 1995/96	<u>9,400</u>
	<u>93,800</u>

The facts

3. The Taxpayer was a car salesman employed by Company A from 1981. For the period between February 1995 and August 1997, the Taxpayer worked for Company B principally as a second-hand car salesman. He later re-joined Company A. The Taxpayer received from Company A and Company B (as the case may be) a monthly salary, bonuses and commission for car sales. He also received commission from finance companies and other companies for introducing clients to them for hire-purchase transactions and the taking out of insurance policies.

4. At the material time, the Taxpayer was also involved in an optical business under the name of Limited Company C and Shop C (collectively ' Company C').

5. On divers dates, Company A and Company B respectively submitted to the Commissioner employer' s return of remuneration and pensions in respect of the Taxpayer for the years of assessment 1990/91 to 1998/99 as follows:

Year of assessment	Employer	Income
		\$
1990/91	Company A	200,207
1991/92	Company A	188,408

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1992/93	Company A	285,697
1993/94	Company A	254,268
1994/95		
(1-4-1994 – 30-9-1994)	Company A	150,906
(6-2-1995 – 3-3-1995)	Company B	17,319
1995/96	Company B	243,280
1996/97	Company B	185,110
1997/98		
(1-4-1997 – 25-8-1997)	Company B	27,909
(15-8-1997 – 31-3-1998)	Company A	153,946
1998/99	Company A	95,680

6. On divers dates, Company D and Company E submitted to the Commissioner returns in respect of commission paid to the Taxpayer as follows:

	Year of assessment	Commission \$
Company D	1991/92	15,249
Company E	1994/95	1,500

7. The Taxpayer submitted income tax returns or tax returns - individuals for the years of assessment 1990/91 to 1998/99 as follows:

(a) Income tax returns

Year of assessment	Assessable income \$	Expenses deducted \$	Date
1990/91	200,207	-	-
1991/92	188,408	30,000 ⁽³⁾	3-4-1992
1992/93	301,807 ⁽¹⁾	60,000 ⁽³⁾	15-7-1993

(b) Tax returns - individuals

Year of assessment	Assessable income \$	Expenses deducted \$	Date
1993/94	254,268	-	15-7-1994
1994/95	168,225 ⁽²⁾	-	30-6-1995
1995/96	243,280	-	-
1996/97	185,110	-	26-5-1997
1997/98	188,918	-	6-6-1998

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1998/99 95,680 - 20-5-1999

- (1) Including \$285,697 from Company A and \$16,100 from Company D.
- (2) Including income from Company A and Company B.
- (3) Including mobile phone, pager and entertainment expenses – not supported by documentary evidence.

8. On divers dates, the assessor raised the following assessments for salaries tax against the Taxpayer:

Year of assessment	Assessable income \$	Expenses deducted \$	Net assessable income \$
1990/91	200,207	-	200,207
1991/92	203,657 ⁽¹⁾	15,000	188,657
1992/93	301,807	26,470 ⁽³⁾	275,337
1993/94	254,268	-	254,268
1994/95	169,725 ⁽²⁾	-	169,725
1995/96	243,280	-	243,280

- (1) Including the undeclared commission of \$15,249 received by the Taxpayer from Company D.
- (2) Including the undeclared commission of \$1,500 received by the Taxpayer from Company E.
- (3) Equivalent to 10% of the receipt of commission.

There was no objection by the Taxpayer to the abovementioned assessments. There was no demand for tax for the years of assessment 1996/97 and 1998/99 because the income submitted by the Taxpayer for assessment was below the taxable limit.

9. In 1996, an investigation was carried out in relation to Company C. It was discovered by the assessor that the bank deposits by the Taxpayer did not tally with his reported income. As a result of the time limit imposed by section 60 of the IRO, on 7 March 1997, the assessor raised an assessment against the Taxpayer for additional tax as follows:

Year of assessment	Additional assessable income \$
1990/91	150,000

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On 29 March 1997, the Taxpayer raised an objection against such assessment.

10. On 25 July 1997, the assessor notified the Taxpayer that she was in the process of obtaining information from banks or third parties in order to deal with his objection.

11. On 28 July 1997, the Taxpayer had an interview with the assessor at which he inquired about the standard for the assessment of additional tax. The assessor informed him about the discrepancies between his bank deposits and his reported income. The Taxpayer did not offer any explanation.

12. On 23 December 1997, the Taxpayer wrote to the Commissioner asking for a statement as to how he had committed any wrong in his tax returns.

13. There was further correspondence between the Taxpayer and the assessor subsequently.

14. On 23 April 1999, the Taxpayer made a complaint at the Complaints Office of the IRD.

15. On the same day, there was another interview between the Taxpayer and the assessor at which the Taxpayer was informed that the assessor was still in the process of collecting information from banks and third parties.

16. In 1999, there was an investigation by the IRD into the trade of motor car salesmen and the question of the reporting of receipt of commission and assessment of the same for tax purposes.

17. On 30 October 1999, Company A submitted revised returns and reported the commission received by the Taxpayer from Company F and other finance companies for introducing hire-purchase transactions as follows:

Year of assessment	Commission
	\$
1992/93	70,237
1993/94	105,876
1994/95	
(1-4-1994 – 30-9-1994)	43,224
1997/98	
(15-8-1997 – 31-3-1998)	24,556
1998/99	13,796

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18. There were subsequent interviews of the Taxpayer by the IRD during which the Taxpayer admitted that he had obtained commission for introducing hire-purchase transactions to companies such as Companies D, F and G. On some occasions, the Taxpayer made the point that he was unable to give further information because the transactions in question took place too long ago.

19. We do not propose to go into the interviews in detail. Suffice it to say that all the interviews were recorded and notes of the interviews were sent to the Taxpayer for comment. He never disputed the accuracy of these notes of interviews.

20. For present purposes, it is sufficient for us to note the fact that, on 2 January 2001, at an interview, an agreement was arrived at between the Taxpayer and the IRD when the Taxpayer signed a document (‘ the Agreement ’) making the following acknowledgments:

‘ 1. I hereby agree that my assessable income be computed as follows:-

<u>Year of Assessment</u>	<u>Net Assessable Income</u>	<u>Net Income already Reported/Assessed</u>	<u>Net Additional Assessable Income</u>
	\$	\$	\$
1990/91	234,743	200,207	34,536
1991/92	219,036	188,657	30,379
1992/93	375,935	275,337	100,598
1993/94	377,063	254,268	122,795
1994/95	219,742	169,725	50,017
1995/96	328,803	243,280	85,523
1996/97	206,061	185,110	20,951
1997/98	267,394	188,900	78,494
1998/99	173,892	95,680	78,212

2. I also agree to accept the following revised assessable/additional assessable income in settlement of the objections against the previous assessments:-

<u>Year of assessment</u>	<u>Revised Assessable Income</u>
	\$
1990/91	234,743
1991/92	219,036
1992/93	375,935
1993/94	377,063’

The Agreement is backed up by a document intituled ‘ Income Schedule ’ of the same date and signed by the Taxpayer. The ‘ Income Schedule ’ makes it quite clear that the Taxpayer had received, inter alia, hire-purchase commission from companies such as

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Companies G and H which had not been reported by him previously. The Agreement also contains the following paragraph:

- ‘ 3. I also understand that acceptance of the above-mentioned assessable income does not conclude the whole matter and that the case will be put up to the Commissioner or Deputy Commissioner for consideration of penal actions under Part XIV of the Inland Revenue Ordinance, which include prosecution, compounding or imposition of Additional Tax. If Additional Tax is imposed, the maximum amount could be treble the amount of the tax undercharged.’

21. The Taxpayer was asked by the Board at the hearing whether he was forced to sign the agreement. He said that he was not and that he signed it just to avoid further trouble.

22. On 22 January 2001, the assessor issued to the Taxpayer assessments or revised assessments and demands for additional salaries tax for the years of assessment 1990/91 to 1995/96 in accordance with the Agreement. There was no objection raised by the Taxpayer.

23. As a result of the investigation which resulted in the signing of the Agreement by the Taxpayer, for the years of assessment 1990/91 to 1998/99, the under-declared assessable income and undercharged tax of the Taxpayer are as follows:

Year of assessment t	Assessable income after revised/ additional assessment	Assessable income before revised/ additional assessment	Under-declared assessable income	Undercharged tax
	\$	\$	\$	\$
1990/91	234,743	200,207	34,536	8,634
1991/92	219,036	188,657	30,379	7,488
1992/93	375,935	275,337	100,598	25,149
1993/94	377,063	254,268	122,795	29,760
1994/95	219,742	169,725	50,017	4,027
1995/96	328,803	243,280	85,523	8,760
1996/97	206,061	185,110	20,951	-
1997/98	267,394	188,900	78,494	-
1998/99	<u>173,892</u>	<u>95,680</u>	<u>78,212</u>	<u>-</u>
	<u>2,402,669</u>	<u>1,801,164</u>	<u>601,505</u>	<u>83,818</u>

The under-declared assessable income amounts to about 25% of the assessable income after the revised/additional assessment.

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24. On 25 May 2001, the Commissioner issued a notice to the Taxpayer under section 82A(4) of the IRO informing the latter that he proposed to assess and demand additional tax against the Taxpayer.
25. By a letter dated 18 June 2001, the Taxpayer raised an objection and made representation against such proposed assessment.
26. On 30 July 2001, the Commissioner issued the six notices referred to in paragraph 2 above.
27. The percentage analysis of the additional tax assessed is set out below:

Year of assessment	Undercharged tax	Additional tax assessed under section 82A	Percentage of additional tax assessed over undercharged tax
	\$	\$	%
1990/91	8,634	9,700	112.34
1991/92	7,488	8,400	112.17
1992/93	25,149	28,300	112.52
1993/94	29,760	33,500	112.56
1994/95	4,027	4,500	111.74
1995/96	<u>8,760</u>	<u>9,400</u>	107.30
	<u>83,818</u>	<u>93,800</u>	111.90

The law

28. Section 82A(1) of the IRO provides as follows:

'82A. Additional tax in certain cases

(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 behalf or on behalf of another person or a partnership; or

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- (b) *makes an incorrect statement in connection with a claim for any deduction or allowance under this Ordinance; or*
- (c) *gives any incorrect information in relation to any matter or thing affecting his own liability to tax or the liability of any other person or of a partnership; or*
- (d) *fails to comply with the requirements of a notice given to him under section 51(1) or (2A); or*
- (e) *fails to comply with section 51(2),*

shall, if no prosecution under section 80(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, statement or information, or would have been so undercharged if the return, statement or information had been accepted as correct; or*
- (ii) *has been undercharged in consequence of the failure to comply with a notice under section 51(1) or (2A) or a failure to comply with section 51(2), or which would have been undercharged if such failure had not been detected.'*

The case of the Taxpayer

29. The Taxpayer put forward a number of grounds in his notice of appeal and/or in his evidence and oral submission in support of his appeal. They can be summarised as follows:

- (a) The IRD delayed in informing him where he had gone wrong in his tax returns as a result of which he was unable at least to produce evidence in support of his claim for deduction of expenses.
- (b) The IRD should have allowed his claim for deduction of expenses to an extent much greater than 10% of the assessable income or profit.
- (c) He had no intention to under-declare his income or profit and he had been misled by his employer and/or the finance companies and other companies from whom he received commission. It was the practice of the trade not to declare such commission.

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- (d) He did not realise that after he had agreed to the revised figures about his assessable income he would still have to pay a penalty which was generally unjust.
- (e) He had financial difficulty because of the downturn in the market.

Conclusion

30. We are of the opinion, first, that the arguments advanced by the Taxpayer do not exonerate him from his duty as a taxpayer to make correct tax returns to the IRD. The IRD very often accepts on trust a return submitted by a taxpayer. The fact that the IRD does not detect in time an under-declaration of income by a taxpayer cannot be used by him to his own advantage. This is made clear in a decision of the Board of Review in D65/00, IRBRD, vol 15, 610 at page 618 as follows:

'... IRD has no duty to inform [a taxpayer] of his previous non-compliance. The fact that IRD has not informed such a person of his previous non-compliance is no licence and no excuse for non-compliance by such person of the current or future notices.'

31. Secondly, for a taxpayer to claim deduction for expenses, he must be able to produce evidence (normally documentary evidence) of such expenses. Even if the expenses claimed are supported by documentary evidence, it is not automatic that the IRD would allow deduction of the whole or part of such expenses. In the absence of such supporting evidence, the IRD can only hazard a guess. We find that a deduction of 10% as a rule of thumb is not unreasonable.

32. There is in fact very little room for the Board to manoeuvre after the Taxpayer had made the admission that he had under-declared his assessable income or profit and signed the Agreement.

33. There is a whole host of authorities to the effect that a taxpayer cannot seek to excuse himself from complying with his duty to make correct returns by claiming that he was ignorant of the law or that he had been misled by someone (even if true), particularly, someone who was consulted only casually. See, for example, the decision of the Board of Review in D179/98, IRBRD, vol 14, 78. Nor can the practice of a particular trade be a valid reason, otherwise the people in the trade would be creating their own law.

34. The fact that a taxpayer had no intention to commit fraud is also not a good excuse. If there was such an intention, the Commissioner would most probably initiate criminal proceedings or impose a heavy penalty, for example, treble the amount of tax undercharged.

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35. Thus, all the reasons advanced by the Taxpayer do not constitute ‘reasonable excuse’ within the meaning of section 82A(1) of the IRO.

36. The financial difficulty on the part of the Taxpayer is also not a valid reason for not paying the penalty. In D71/91, IRBRD, vol 7, 1 at page 7, it was said by the Board of Review:

‘...the ability of a taxpayer to pay an assessment is not a matter for the Board...’

37. It is clear from the authorities, for example, Board of Review decision D52/93, IRBRD, vol 8, 372, that the standard practice is to use as a starting point penalty equivalent to 100% of the tax underpaid in cases of this nature. Here, the Taxpayer has been given an average penalty of 112% as against a maximum of 300%.

38. The Commissioner has put forward factors taken into consideration by him in arriving at the percentages including the following:

- (a) The fact that for the nine years of assessment of 1990/91 to 1998/99 the Taxpayer continuously did not declare his income from third parties other than his employer.
- (b) The fact that the Taxpayer was a senior and experienced car salesman and was involved in the optical business.
- (c) The fact that the investigation took four years and that the Taxpayer did not adopt a co-operative attitude towards the IRD.

39. In all the circumstances, we have no basis or justification for saying that the Commissioner has been wrong in imposing such a penalty.

40. In the circumstances, we have no alternative but to dismiss the Taxpayer’s appeal.