

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D171/01

Penalty tax – understating profits – whether penalty excessive.

Panel: Patrick Fung Pak Tung SC (chairman), Duffy Wong Chun Nam and Adrian Wong Koon Man.

Date of hearing: 10 December 2001.

Date of decision: 20 March 2002.

In these two appeals, the taxpayers understated their profits. Additional tax of about 100% of the underpaid tax was imposed against each taxpayer.

They appealed against the penalties as being excessive.

Held:

1. The Board found both taxpayers had no reasonable excuse in understating their profits.
2. The penalties followed the standard practice, this is, 100% of the tax underpaid. Thus, they were not excessive in the circumstances.

Appeal dismissed.

Cases referred to:

D24/84, IRBRD, vol 2, 136

D71/91, IRBRD, vol 7, 1

Ng Kuen Wai Trading as Willie Textiles v Deloitte Touche Tohmatsu and Commissioner of
Inland Revenue 5 HKTC 211

D52/93, IRBRD, vol 8, 372

Yeung Ka Sing for the Commissioner of Inland Revenue.

INLAND REVENUE BOARD OF REVIEW DECISIONS

D P Lau of Messrs D P Lau & Co for the taxpayers.

Decision:

1. These are two appeals by the Appellant in each of B/R 130/01 and B/R 131/01 against the assessment by the Respondent (‘ the Commissioner’) against each of them individually for additional tax under section 82A of the Inland Revenue Ordinance (‘ IRO’).

2. The two appeals were heard together and the Appellants, who are husband and wife, were both represented by Mr D P Lau (‘ Mr Lau’) of Messrs D P Lau & Co, Certified Public Accountants. The Appellants were asked expressly whether they proposed to give evidence under oath. They declined to do so and elected to give unsworn evidence. Consequently, their evidence was not tested by cross-examination. They gave evidence in turn and sometimes jointly which supplemented each other’ s case.

3. Although the two appeals were heard together, basically they are separate and distinct cases arising out of separate and distinct notices of assessment issued by the Commissioner. We shall deal with the two appeals separately below.

B/R 130/01

4. On 17 August 2001, the Commissioner issued notices of assessment and demand for additional tax against the Appellant in this case (‘ Taxpayer I’) in relation to the following years of assessment and amounts:

	\$
(a) 1994/95	24,000
(b) 1995/96	41,000
(c) 1996/97	63,000
(d) 1997/98	97,000
(e) 1998/99	<u>52,000</u>
	<u><u>277,000</u></u>

5. By a letter written jointly with the Appellant in B/R 131/01 (‘ Taxpayer II’) and dated 11 September 2001, Taxpayer I lodged his appeal against the notices of assessment and demand referred to in paragraph 4 above.

The facts

INLAND REVENUE BOARD OF REVIEW DECISIONS

6. The statement of facts presented by the Commissioner to the Board is agreed or, at least, not challenged by Taxpayer I.

7. At all material times since about 15 April 1994, Taxpayer I carried on the business of transporter of building materials and disposer of building debris as the sole proprietor of Company A.

8. For the years of assessment 1994/95 to 1998/99, Taxpayer I made tax returns in relation to Company A as follows:

Year of assessment	Reported gross profits	Reported assessable profits
	\$	\$
1994/95	612,821	63,775
1995/96	793,218	100,730
1996/97	1,242,311	187,688
1997/98	1,601,325	235,891
1998/99	1,641,418	284,516

9. Relying on the tax returns made by Taxpayer I, the Inland Revenue Department ('IRD') assessed and demanded profits tax against Taxpayer I as follows:

Year of assessment	Date of issue	Amount of profits tax
		\$
1995/96	18-2-1997	100,730
1996/97	10-9-1997	187,688
1997/98	14-10-1998	235,891

10. Subsequently, at various stages from 2 November 1999, the IRD queried Taxpayer I as to the sources of his funds used for the purchase of certain real properties in Kowloon.

11. The IRD was not convinced by the answers to the queries given by Taxpayer I and on 2 December 1999, the IRD assessed and demanded profits tax against Taxpayer I for the year of assessment 1998/99 on the basis of assessable profits in the sum of \$750,000. Taxpayer I objected to such assessment.

12. Subsequently, the IRD carried out further investigation into the business of Taxpayer I and interviewed him (and Taxpayer II) on a number of occasions.

13. In the course of the interviews, Taxpayer I admitted to the IRD that he had not kept the relevant invoices, sales records and wage records in his business. Furthermore, Taxpayer I gave unsatisfactory answers to the IRD regarding alleged loans to him from third parties.

INLAND REVENUE BOARD OF REVIEW DECISIONS

14. The investigation and negotiations between Taxpayer I and his tax representative and the IRD culminated in a document dated 11 January 2001 (‘ Agreement I ’) being addressed to the IRD and signed by Taxpayer I. It reads as follows:

- ‘ 1. I hereby agree that the assessable profits of the above business be computed as follows:-

<u>Year of Assessment</u>	<u>Assessable Profits</u>	<u>Profits/(Loss) already Reported/Assessed</u>	<u>Additional Assessable Profits</u>
	\$	\$	\$
1994/95	226,812	0	226,812
1995/96	311,760	100,730	211,030
1996/97	522,624	187,688	334,936
1997/98	822,034	235,891	586,143
1998/99	<u>721,205</u>	<u>284,516</u>	<u>436,689</u>
Total	<u>2,604,435</u>	<u>808,825</u>	<u>1,795,610</u>

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

<u>Year of Assessment</u>	<u>Revised Assessable Income</u>
	\$
1994/95	226,812
1998/99	721,205

3. I also understand that acceptance of the above-mentioned assessable profits 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.’

15. On 27 March 2001, based on Agreement I, the IRD made a revised assessment and demand for profits tax against Taxpayer I as follows:

Year of assessment	Revised/Additional assessable profits		Tax payable
	\$		\$
1994/95	226,812	[revised]	23,162
1995/96	211,030	[additional]	38,197

INLAND REVENUE BOARD OF REVIEW DECISIONS

1996/97	334,936	[additional]	62,034
1997/98	586,143	[additional]	101,792
1998/99	<u>721,205</u>	[revised]	<u>62,451</u>
	<u>2,080,126</u>		<u>287,636</u>

There was no objection by Taxpayer I against such assessments.

16. Thus, after investigation by the IRD, it was discovered that for the years of assessment 1994/95 to 1998/99, Taxpayer I had under-declared profits and underpaid tax as follows:

Year of assessment	Assessable profits already reported/ assessed before investigation	Assessable profits after investigation	Under-declared assessable profits	Underpaid tax
	\$	\$	\$	\$
1994/95	63,775	226,812	163,037	23,162
1995/96	100,730	311,760	211,030	38,197
1996/97	187,688	522,624	334,936	62,034
1997/98	235,891	822,034	586,143	101,792
1998/99	<u>284,516</u>	<u>721,205</u>	<u>436,689</u>	<u>62,451</u>
	<u>872,600</u>	<u>2,604,435</u>	<u>1,731,835</u>	<u>287,636</u>

The under-declared assessable profits amount to 66.5% of the assessable profits after investigation.

17. On 11 June 2001, the Commissioner issued a notice under section 82A(4) of the IRO informing Taxpayer I of his intention to assess and demand against him additional tax under section 82A of the IRO for having made incorrect tax returns.

18. By a letter dated 3 July 2001, Taxpayer I through his tax representative objected to such notice.

19. On 12 August 2001, the Commissioner issued the five notices referred to in paragraph 4 above.

20. 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
--------------------	------------------	-------------------------------------------	-------------------------------------------------------------

INLAND REVENUE BOARD OF REVIEW DECISIONS

	\$	\$	%
1994/95	23,162	24,000	103.62
1995/96	38,197	41,000	107.34
1996/97	62,034	63,000	101.56
1997/98	101,792	97,000	95.29
1998/99	<u>62,451</u>	<u>52,000</u>	83.27
	<u>287,636</u>	<u>277,000</u>	96.30

The law

21. 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*
- (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*

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (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.'*

22. Section 68(4) of the IRO provides that on an appeal: '*The onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant*' .

The case of Taxpayer I

23. The case of Taxpayer I can be summarised as follows:

- (a) He is not well educated. He had already done his best in keeping the relevant books and accounts.
- (b) He had no intention to cheat the IRD and had co-operated with the IRD in its investigation.
- (c) He and his wife are in great financial difficulty and their real property assets have become negative in value.
- (d) Although he signed Agreement I, he did not really understand the figures and he left the matter to his tax representative, Ms B, who worked out the figures with the officials in the IRD. Furthermore, at the time he signed Agreement I, his mother was suffering from cancer.
- (e) Mr Lau had heard rumours to the effect that the IRD had revised or was going to revise its policy about assessing and demanding additional tax under section 82A of the IRO in favour of taxpayers in general. If that was so, Taxpayer I (and Taxpayer II) should be given the benefit of the same.

Conclusion

24. It is well-established law that the responsibility is on a taxpayer to keep proper accounts and records and make correct returns to the IRD. There is also ample authority in support of the proposition that the fact that a taxpayer is not well educated or is ignorant of the law does not relieve him from such responsibility. See, for example, the decisions of the Board of Review in D24/84, IRBRD, vol 2, 136 and D71/91, IRBRD, vol 7, 1.

INLAND REVENUE BOARD OF REVIEW DECISIONS

25. Secondly, 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.

26. Thirdly, there is in fact very little room for the Board to manoeuvre after Taxpayer I had made the admission that he had under-declared his assessable income or profit and signed Agreement I. It is not alleged that Taxpayer I was forced to sign Agreement I or that he did so as a result of improper inducement on the part of the IRD. In fact, at all material times, he was assisted and advised by his tax representative who negotiated with the IRD on his behalf. The Board can only assume that he was properly and competently advised by his own tax representative.

27. In the case of Ng Kuen Wai Trading as Willie Textiles v Deloitte Touche Tohmatsu and Commissioner of Inland Revenue 5 HKTC 211, it was held by the Court of First Instance that the taxpayer would not rescind an agreement with the IRD such as Agreement I in the present case.

28. The Board is further not aware of any plan or decision by the IRD to revise its policy on additional tax under section 82A of the IRO.

29. The financial difficulty on the part of a taxpayer is also not a valid reason for not paying the penalty. In D71/91 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...’

30. 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, Taxpayer I has been given only an average penalty of 96.3% as opposed to 100%.

31. Bearing in mind especially the fact that no sworn evidence from any witness has been adduced by Taxpayer I and the principle that on such an appeal the burden is on an appellant to show that the assessment by the Commissioner is excessive or wrong, we have come to the conclusion that Taxpayer I has not discharged such burden.

32. We have a lot of sympathy for Taxpayer I (and Taxpayer II) who showed much emotion at the hearing of the appeal. We do not have much doubt about their financial difficulty. Nevertheless, we are duty-bound to deal with such appeals according to the law.

33. Accordingly, we have no alternative but to dismiss the appeal of Taxpayer I.

B/R 131/01

INLAND REVENUE BOARD OF REVIEW DECISIONS

34. On 17 August 2001, the Commissioner issued notices of assessment and demand for additional tax against Taxpayer II in relation to the following years of assessment and amounts:

	\$
(a) 1996/97	3,000
(b) 1997/98	<u>1,300</u>
	<u>4,300</u>

35. By the said letter written jointly with Taxpayer I and dated 11 September 2001, Taxpayer II lodged her appeal against the notices of assessment and demand referred to in paragraph 34 above.

The facts

36. The statement of facts presented by the Commissioner to the Board is agreed or, at least, not challenged by Taxpayer II.

37. On 1 April 1993, Taxpayer II started carrying on the business of selling embroidered clothing under the trade name of Company C as a sole proprietor.

38. For the years of assessment 1994/95 to 1998/99, Taxpayer II made tax returns in relation to Company C as follows:

Year of assessment	Reported gross profits	Reported assessable profits
	\$	\$
1994/95	286,366	61,377
1995/96	289,730	38,259
1996/97	95,269	16,364
1997/98	25,900	1,328
1998/99	22,125	(1,609)

39. Relying on the tax returns made by Taxpayer II, the IRD assessed and demanded profits tax against Taxpayer II as follows:

Year of assessment	Date of issue	Amount of profits tax
		\$
1994/95	27-9-1995	61,377
1995/96	26-6-1997	38,259
1996/97	10-9-1997	16,364
1997/98	14-10-1998	1,328

INLAND REVENUE BOARD OF REVIEW DECISIONS

40. Subsequently, at various stages from 2 November 1999, the IRD queried Taxpayer II as to the sources of her funds used for the purchase of certain real properties in Kowloon.

41. On 30 November 1999, the IRD assessed and demanded profits tax against Taxpayer II for the year of assessment 1998/99 on the basis of assessable profits in the sum of \$500,000. Taxpayer II objected to such assessment.

42. Subsequently, the IRD carried out further investigation into the business of Taxpayer II and interviewed her (and Taxpayer I) on a number of occasions.

43. The investigation and negotiations between Taxpayer II and her tax representative and the IRD culminated in two documents dated 11 January 2001 being addressed to the IRD and signed by Taxpayer II.

44. The first document (‘ Agreement II ’) is in relation to Taxpayer II’s business of Company C. It reads as follows:

- ‘ 1. I hereby agree that the assessable profits of the above business be computed as follows:-

<u>Year of Assessment</u>	<u>Assessable Profits</u>	<u>Profits/(Loss) already Reported/Assessed</u>	<u>Additional Assessable Profits</u>
	\$	\$	\$
1994/95	70,345	61,377	8,968
1995/96	47,302	38,259	9,043
1996/97	25,164	16,364	8,800
1997/98	10,928	1,328	9,600
1998/99	<u>7,991</u>	<u>(1,609)</u>	<u>9,600</u>
Total	<u>161,730</u>	<u>115,719</u>	<u>46,011</u>

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

<u>Year of Assessment</u>	<u>Revised Assessable Profits</u>
	\$
1998/99	7,991

3. I also understand that acceptance of the above-mentioned assessable profits 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,

INLAND REVENUE BOARD OF REVIEW DECISIONS

compounding or imposition of Additional Tax. If Additional Tax is imposed, the maximum amount could be treble the amount of the tax undercharged.'

45. The second document (' Agreement III ') is in relation to Taxpayer II' s income from her employment as a part-time salesperson in the year of assessment 1998/99 which she admitted to have failed to declare. It reads as follows:

' I hereby agree that my assessable income be computed as follows:-

<u>Year of Assessment</u>	<u>Income already Reported/Assessed</u>	<u>Agreed Assessable Income</u>	<u>Understated Assessable Income</u>
	\$	\$	\$
1998/99	<u>0</u>	<u>15,930</u>	<u>15,930</u>
Total	<u>0</u>	<u>15,930</u>	<u>15,930</u>

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.'

46. On 27 March 2001, based on Agreement II and Agreement III, the IRD made a revised assessment and demand for profits tax against Taxpayer II as follows:

Year of assessment	Revised/Additional assessable profits	Tax payable
	\$	\$
1994/95	8,968	[additional] 0
1995/96	9,043	[additional] 0
1996/97	8,800	[additional] 2,959
1997/98	9,600	[additional] 1,362
1998/99	<u>7,991</u>	[revised] 0
	<u>44,402</u>	<u>4,321</u>

47. Thus, after investigation by the IRD, it was discovered that for the years of assessment 1994/95 to 1998/99, Taxpayer II had under-declared profits and underpaid tax as follows:

Year of assessment	Assessable profits already reported/ assessed before	Assessable profits after investigation	Under-declared assessable profits	Underpaid tax
---------------------------	-------------------------------------------------------------	-----------------------------------------------	------------------------------------------	----------------------

INLAND REVENUE BOARD OF REVIEW DECISIONS

	investigation			
	\$	\$	\$	\$
1994/95	61,377	70,345	8,968	0
1995/96	38,259	47,302	9,043	0
1996/97	16,364	25,164	8,800	2,959
1997/98	1,328	10,928	9,600	1,362
1998/99	<u>(1,609)</u>	<u>7,991</u>	<u>9,600</u>	<u>0</u>
	<u><u>115,719</u></u>	<u><u>161,730</u></u>	<u><u>46,011</u></u>	<u><u>4,321</u></u>

The under-declared assessable profits amount to 50.98% of the assessable profits after investigation.

48. On 11 June 2001, the Commissioner issued a notice under section 82A(4) of the IRO informing Taxpayer II of his intention to assess and demand against her additional tax under section 82A of the IRO for having made incorrect tax returns.

49. There was no objection by Taxpayer II to such notice.

50. On 12 August 2001, the Commissioner issued the two notices referred to in paragraph 34 above.

51. 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
	\$	\$	%
1996/97	2,959	3,000	101.39
1997/98	<u>1,362</u>	<u>1,300</u>	95.45
	<u><u>4,321</u></u>	<u><u>4,300</u></u>	99.51

The case of Taxpayer II

52. The case of Taxpayer II was argued along the same lines as Taxpayer I.

Conclusion

53. The law as set out in paragraphs 21 and 22 above are equally applicable to Taxpayer II's appeal.

INLAND REVENUE BOARD OF REVIEW DECISIONS

54. We have already dealt with the same points as raised in Taxpayer II' s appeal when we addressed them in Taxpayer I' s appeal above.
55. Accordingly, we also have no alternative but to dismiss the appeal of Taxpayer II.