

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D33/88

Penalty assessment – whether penalty excessive – general yardstick for calculation of penalties – s 82A of the Inland Revenue Ordinance.

Panel: William Turnbull (chairman), Albert Ho Chun Yan and Wilfred Lee Chee Wah.

Date of hearing: 19 July 1988.

Date of decision: 23 August 1988.

The taxpayer carried on business of buying pigs for customers. For six years, he kept no accounts and did not submit any profits tax returns. After investigation, he submitted returns which understated his profits. After negotiations, he accepted an informal assets betterment statement which showed higher profits than those previously declared by him.

The Commissioner issued a penalty assessment. The penalties levied were equal to between 120% and 135% (average 134%) of the tax that would have been undercharged if the taxpayer's late returns had been accepted.

Held:

The penalties were excessive.

- (a) The starting point for assessing penalties, where the taxpayer has not attempted to evade tax, is the amount of tax undercharged. This is not a hard and fast rule.
- (b) The taxpayer should have known that he was subject to tax, and he had simply ignored his obligations. A substantial penalty was therefore appropriate.
- (c) The taxpayer was no more culpable than in other cases where much lighter penalties have been imposed. Accordingly, the penalty would be reduced to between 80% and 90% (average 89%) of the tax that would have been undercharged if the taxpayer's late returns had been accepted.

Appeal allowed.

Raymond Ng for the Commissioner of Inland Revenue.

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Chang Yau Hung of Gary Mak & Co for the taxpayer.

Decision:

This is an appeal by an individual carrying on business as a pig trader in relation to certain penalty tax assessments made against him under section 82A. The relevant facts can be summarised as follows:

1. The Taxpayer was a private individual who had for many years been carrying on business as a pig trader. The Taxpayer attended the Hong Kong Government pig market in the Western District of Hong Kong Island where he purchased pigs for his customers. His main business was not purchasing pigs for his own account but for the account of his customers. He was carrying on a very unsophisticated type of business and the income which he derived from his business was little more than enough to maintain himself and his family members.
2. Prior to establishing his own business, the Taxpayer had been an employee of another organisation which carried out similar business. The Taxpayer had set himself up in business and his main sources of income were retainers paid to him by his various customers for his services as their agent. The Taxpayer did not keep books or accounts and did not report any of his income to the Inland Revenue Department.
3. In or about November 1982, the Inland Revenue Department made enquiries and the Taxpayer was informed that the nature of his activities constituted the carrying on of a profession and that he should be subject to profits tax. Profits tax returns were then issued to the Taxpayer for the years of assessment 1976/77 to 1981/82.
4. In January 1983, the Taxpayer submitted profits tax returns in which he returned taxable profits as follows:

<u>Year of Assessment</u>	<u>Basic Period</u>	<u>Returned Profits</u> \$
1976/77	Year ended 31-12-1976	46,800
1977/78	Year ended 31-12-1977	44,200
1978/79	Year ended 31-12-1978	37,700
1979/80	Year ended 31-12-1979	39,000
1980/81	Year ended 31-12-1980	56,100
1981/82	Year ended 31-12-1981	72,100

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5. The assessor was not satisfied with these tax returns and an investigation into the affairs of the Taxpayer was carried out by the Inland Revenue Department. In the course of this investigation, the following three assessments were issued:

<u>Year of Assessment</u>	<u>Estimated Assessable Profits</u> \$	<u>Date of Issue</u>
1976/77	200,000	4-3-1983
1977/78	260,000	19-3-1984
1978/79	250,000	21-3-1985

6. The Taxpayer lodged valid notices of objection to these three assessments.
7. In the course of the investigations, the investigating officers prepared an informal assets betterment statement which showed that the taxable income of the Taxpayer during the period from 1976/77 to 1981/82 was \$780,000. In February 1986, the investigating officers proposed to the Taxpayer that his liability to profits tax should be settled on this basis and the Taxpayer agreed thereto.
8. On 3 March 1986, revised assessments for the years of assessment 1976/77 to 1978/79 and assessments for the years of assessment 1979/80 to 1981/82 were issued in the sum of \$130,000 profits assessed for each of the six years in question.
9. The Deputy Commissioner of Inland Revenue was of the opinion that the Taxpayer had, without reasonable excuse, failed to inform the Commissioner in writing that he was chargeable to tax for the years of assessment 1976/77 to 1981/82 within the period prescribed under section 51(2) and gave notice of his intention to assess additional tax under section 82A of the Inland Revenue Ordinance. In reply to this notice, the Taxpayer submitted representations and, after taking the representations into account, the Deputy Commissioner of Inland Revenue on 28 May 1986 made the following additional tax assessments under section 82A on the Taxpayer in respect of his failure to inform the Commissioner of his chargeability to tax:

<u>Year of Assessment</u>	<u>Tax Undercharged</u> \$	<u>Section 82A Additional Tax</u> \$
1976/77	19,500	26,300
1977/78	19,500	26,300
1978/79	20,700	28,000

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1979/80	19,500	26,300
1980/81	10,804	14,000
1981/82	<u>2,496</u>	<u>3,000</u>
	<u>92,500</u>	<u>123,900</u>

The Taxpayer has appealed against these section 82A assessments.

10. At the hearing of the appeal, the Taxpayer was duly represented and both he and his wife and daughter were also present.

Having heard the representations by the Taxpayer's representative and the Commissioner's representative, we find that the assessments appealed against are indeed excessive. In a number of recent cases which have now been reported, it would appear that the starting point for assessing penalties in cases of this nature where it is not alleged that the Taxpayer has attempted to evade payment of tax is a penalty of approximately one times the amount of tax undercharged or one-third of the total maximum penalty of three times. This is not a hard and fast rule but is a useful starting point.

The Taxpayer is an unsophisticated individual who, according to his own submission, had been an employee of a meat company and had gradually established his own business receiving payment from customers which he thought was his monthly salary. It would appear that, until the Inland Revenue had commenced investigations, he did not keep accounts and did not know that he should keep accounts or indeed that he was carrying on business in a professional manner. The Taxpayer was then given the opportunity of filing tax returns which he did but, for reasons unexplained, it would appear that the summary statements of accounts attached to his returns understated his gross income. It is clear from the informal assets betterment statement which was produced by the Inland Revenue Department at the request of the Board in the course of the hearing that the Taxpayer must have had additional income which was not disclosed in the tax returns. As the tax returns were filed some years after the events and as the Taxpayer did not keep any records of his income or expenditure, this is perhaps explicable if not excusable.

The legislature has decided that it is appropriate to protect the public revenue by imposing very severe penalties on those who fail to perform their obligations under the Inland Revenue Ordinance. Whether or not the Taxpayer thought that his income was in the form of salary or whether it was in fact the income of a profession which he was carrying on is not really material. The fact is that he was earning substantial sums of money which he should have known were subject to some form of tax under the Inland Revenue Ordinance. There can be no excuse for his simply ignoring his obligations under the Inland Revenue Ordinance either as a salaried employee (which he thought he was) or as the proprietor of a professional business (which is in fact what he was).

If the Inland Revenue Department had not made enquiries, the Taxpayer would never have paid any tax. This cannot be excused and it is right and proper that a substantial

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penalty should be imposed upon the Taxpayer for his failure to notify the Commissioner of his correct taxable income.

However, when one considers the quantum of the penalties to be imposed, it would seem that the maximum should be approximately an amount equal to the tax which the Taxpayer would otherwise not have paid and not the amount of the penalties assessed by the Deputy Commissioner. The Taxpayer's 'culpability' in this case is no more than in many other cases where the Commissioner or Deputy Commissioner have imposed much lighter penalties.

In all of the circumstances and taking into account all of the facts, we decide that the penalties should be reduced from the total sum of \$123,900 by the sum of \$41,300 to a total sum of \$82,600 to be apportioned over the 6 years in question as follows:

<u>Year of Assessment</u>	<u>Section 82A Additional Tax as originally assessed</u> \$	<u>Section 82A Additional Tax as reduced by Board of Review</u> \$
1976/77	26,300	17,533
1977/78	26,300	17,533
1978/79	28,000	18,667
1979/80	26,300	17,534
1980/81	14,000	9,333
1981/82	<u>3,000</u>	<u>2,000</u>
	<u>\$123,900</u>	<u>\$82,600</u>

The Board of Review orders that the assessments appealed against be reduced accordingly.