

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D52/91

Penalty tax – quantum of penalty – obligation to maintain proper accounts – section 82A of the Inland Revenue Ordinance.

Panel: William Turnbull (chairman), David A Morris and Winston Lo Yau Lai.

Date of hearing: 4 July 1991.

Date of decision: 24 September 1991.

The taxpayer was a seaman with little business or accounting knowledge and limited education who established a trading business. Because of his lack of accounting knowledge, he did not keep full accounting records and filed incorrect returns. Following investigations by the Inland Revenue Department, it was agreed that he had understated his profits. The Commissioner imposed penalties upon the taxpayer under section 82A of the Inland Revenue Ordinance of 80% of the amount of tax undercharged. The taxpayer appealed to the Board of Review on the ground that the penalties were excessive.

Held:

The penalties were not excessive. There were strong mitigating factors which the Commissioner had taken into account. There is an obligation upon any person carrying on business to maintain proper accounts and the taxpayer had failed to do so.

Appeal dismissed.

Tse Hon Kin for the Commissioner of Inland Revenue.

Taxpayer in person.

Decision:

This is an appeal by a taxpayer against a number of penalty tax assessments raised upon him under section 82A of the Inland Revenue Ordinance. The facts are as follows:

1. The Taxpayer was a seaman with little business or accounting knowledge and limited education. After being at sea for many years, he wished to live at home with his family. In 1980 he left the sea and established a trading business.

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Because of his lack of accounting knowledge he did not keep full accounting records. He filed returns for the years of assessment 1983/84 to 1989/90.

2. On 11 October 1989, the Taxpayer attended an interview with the investigation officers at the Inland Revenue Department and was told that his tax affairs were being investigated. It was pointed out to the Taxpayer that there were large discrepancies between his bank accounts and the business turnover which he had reported. The Taxpayer was asked to look into the matter and to inform the Inland Revenue Department whether or not the previous tax returns were correct.
3. On 1 November 1989 the Taxpayer wrote to the Inland Revenue Department saying that the profits reported were not correct and that he would submit revised accounts. On 22 November 1989 he did submit revised accounts which were not accepted by the Inland Revenue Department who requested him to supply the working papers and underlying records which had formed the basis of the revised accounts and to explain why the gross profits ratio shown in the revised accounts had substantially reduced.
4. Following further enquiries by the Inland Revenue Department and negotiations, it was agreed that the business profits of the Taxpayer would be calculated by applying an agreed gross profit ratio. The matter was then agreed between the Taxpayer and the Inland Revenue Department on the following basis:

<u>Year of Assessment</u>	<u>Profits Before Investigation</u> \$	<u>Profits After Investigation</u> \$	<u>Profits Undercharged</u> \$	<u>Tax Undercharged</u> \$
1983/84	88,045	200,490	112,445	25,943
1984/85	88,695	178,992	90,297	20,504
1985/86	83,840	159,972	76,132	15,659
1986/87	86,780	278,100	191,320	44,086
1987/88	93,480	259,552	166,072	41,562
1988/89	105,740	270,887	165,147	41,966
1989/90	<u>123,800</u>	<u>271,167</u>	<u>147,367</u>	<u>37,020</u>
	<u>670,380</u>	<u>1,619,160</u>	<u>948,780</u>	<u>226,740</u>

5. The Commissioner of Inland Revenue was of the opinion that the Taxpayer had without reasonable excuse made incorrect profits returns for the years of assessment 1983/84 to 1989/90 and on 26 February 1991 gave notice to the Taxpayer that he proposed to assess additional tax by way of penalty.

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6. The Taxpayer submitted representations and after taking into account the representations, the Commissioner of Inland Revenue on 15 April 1991 assessed the Taxpayer to additional tax under section 82A of the Inland Revenue Ordinance as follows:

<u>Year of Assessment</u>	<u>Tax Undercharged</u> \$	<u>Section 82A Additional Tax</u> \$	<u>Percentage of Penalty Tax</u> %
1983/84	25,943	20,700	80
1984/85	20,504	16,400	80
1985/86	15,659	12,500	80
1986/87	44,086	35,200	80
1987/88	41,562	33,200	80
1988/89	41,966	33,500	80
1989/90	<u>37,020</u>	<u>29,600</u>	<u>80</u>
	<u>226,740</u>	<u>181,100</u>	80

The Taxpayer duly gave notice of appeal to the Board of Review.

At the hearing of the appeal, the Taxpayer appeared in person and gave a very favourable impression to the members of the Board of Review. From what he said, it was apparent that the business which he had been operating was largely a cash based business and had at one time included his purchasing overseas for cash goods which he had then resold in Hong Kong to shops and traders. It was also clear that though the Taxpayer clearly had considerable business skills, he had little or no knowledge or understanding of accounting. He explained to the Board that a substantial sum of cash had been stolen from him when he had been overseas purchasing stock for his business and he also explained that recently he had suffered some significant bad debts. He said that none of these had been taken into account by the Inland Revenue Department.

The representative for the Commissioner pointed out that after the investigation had commenced, the turnover figures of the Taxpayer had jumped very substantially. He pointed out that because the Taxpayer did not keep any proper books of account, it had been impossible to compile an assets betterment statement or to verify the business accounts. Because of this, the procedure of assuming a gross profit ratio for the business had been used. He said that the Taxpayer had notified the Inland Revenue Department of certain bad debts and all of the bad debts which the Taxpayer had claimed in the course of the investigation had been allowed. However, additional bad debts which he was now claiming had been incurred had not been allowed. Obviously the Inland Revenue Department could not allow bad debts about which they had no knowledge at the time.

The representative for the Commissioner pointed out that this was not a case of full voluntary disclosure because the investigation had been instigated by the Inland

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Revenue Department and the Taxpayer had not been able to make full disclosure because he did not have any records and accounts.

The representative for the Commissioner pointed out that the total amount of the penalties imposed was only 80% of the tax undercharged which was less than the norm and indicated that the Commissioner had already taken a lenient view of this matter.

As stated above, the Taxpayer gave a very favourable impression to the Board of Review who have substantial sympathy for him. However and unfortunately for the Taxpayer, sympathy alone is not sufficient. In Hong Kong we have a simple system of taxation and all people carrying on business in Hong Kong, including the Taxpayer, know that they must keep records of their profits, file tax returns, and pay tax. This the Taxpayer has failed to do. Where a taxpayer fails in his obligations under the Inland Revenue Ordinance, the starting point for assessing penalties has been accepted to be an amount equal to the amount of the tax undercharged. In the present case the Commissioner has already taken a lenient view of the matter and has reduced the amount of the penalties to only 80% of the amount of tax undercharged. In all of the circumstances we are not able to decide that this penalty is in any way excessive. We appreciate that the Taxpayer has limited education and little accounting knowledge. However, he chose to go into business for his own account and any one who operates a business must do so within the ambit of our legal system which includes the Inland Revenue Ordinance. A person carrying on business is obliged to maintain proper accounts. This the Taxpayer has failed to do.

We appreciate the point made by the Taxpayer which was that the method of assessing the profits which he made is rough and ready. It is imprecise. It may well be that the amount of the profits ultimately assessed was higher than the actual profits made. Of course the converse may be the case and it could be that larger profits were in fact made. However what the Taxpayer must realise is that he alone has caused this state of affairs to arise. It was he himself who decided to go into business and it was he who neglected to keep proper accounts. He cannot now complain about something which is his own fault.

In particular we would mention that the submission which the Taxpayer made regarding bad debts which he said the Inland Revenue Department had not taken into account has no substance because the Taxpayer failed to inform the Inland Revenue Department about these bad debts at the time when his tax affairs were being investigated and settled. Such bad debts as he did mention were allowed. Presumably the bad debts to which the Taxpayer referred at the hearing of the appeal became bad debts subsequent to the investigation and settlement of his tax affairs. The proper course is for him now to ensure that these bad debts are included in his current accounts on the basis that they have become bad subsequent to his previous tax affairs being settled.

As stated in all of the circumstances, we find that the penalties against which the Taxpayer has appealed are not excessive and confirm the same.