

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D53/92

Penalty tax – incorrect tax returns by professional person – quantum of penalties – penalties increased – section 82A of Inland Revenue Ordinance.

Panel: William Turnbull (chairman), Eugene Ho and Jao Yu Ching.

Dates of hearing: 15 September, 1 and 2 December 1992.

Date of decision: 11 February 1993.

The taxpayer had carried on a professional practice. He subsequently left Hong Kong for a period of time. During his absence he filed tax returns in respect of his wife's income and claimed as deductions therefrom alleged expenses of his business. The taxpayer gave evidence before the Board to substantiate the fact that he was carrying on business in Hong Kong and had incurred expenses which could legitimately be set off against other taxable income.

Held:

The Board totally rejected the evidence given by the taxpayer and considered that the taxpayer had embarked upon a plan or scheme to minimize his tax liabilities by claiming totally fictitious expenses. In the circumstances the Board increased the penalties to amounts equal to 200% of the tax involved.

Appeal dismissed.

[Editor's note: The taxpayer has filed an appeal against this decision.]

Lee Kang Bor for the Commissioner of Inland Revenue.

K Sundara – M of Messrs John Massie & Co for the taxpayer.

Decision:

This is an appeal by a taxpayer against the imposition of certain penalties imposed upon him under section 82A of the Inland Revenue Ordinance in respect of the years of assessment 1986/87, 1987/88 and 1988/89. The facts of the case are as follows:

1. The Taxpayer had carried on a professional practice ('the practice') which he commenced in late 1970.

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2. Between early 1984 and late 1989 the Taxpayer was resident in Country S and during that period he acquired the citizenship of Country S. The wife of the Taxpayer who was also a professional person was gainfully employed in Hong Kong and remained in Hong Kong whilst the Taxpayer was absent in Country S.
3. During the three years of assessment 1986/87 to 1988/89 the wife of the Taxpayer earned income which was liable to be assessed to salaries tax. The Taxpayer elected to be personally assessed for those years of assessment and in his personal assessment returns for those years declared that his wife had the following income chargeable to salaries tax and that he had the following assessable losses from the practice:

<u>Year of Assessment</u>	<u>Taxpayer's Wife's Income</u>	<u>Business Losses</u>
	\$	\$
1986/87	453,799	(285,703)
1987/88	490,536	(271,806)
1988/89	524,824	(267,404)

4. The accounts of the practice which accompanied the profits tax returns filed for the relevant years showed that it did not have any fee income throughout the whole period of three years.
5. The assessor did not accept that the Taxpayer was carrying on a trade profession or business during the three years of assessment and did not accept the losses claimed. The assessor issued three assessments on the full amount of the income of the Taxpayer's wife save and except for a deduction of \$30,182 in respect of the year of assessment 1986/87 which was a carry forward loss from a previous year.
6. The Taxpayer objected to each of these assessments alleging that in each of the years to which the assessments related the losses of the practice had been wrongly disallowed by the assessor.
7. The accounts of the practice included in respect of each year a profit and loss account and tax computation. Each of the profit and loss accounts showed 'professional fees received' as 'nil'. Under a heading of 'general expenses and administration expenses' a number of items were set out as follows:

Year ended Year ended Year ended

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	<u>31-3-1987</u>	<u>31-3-1988</u>	<u>31-3-1989</u>
	\$	\$	\$
Accountancy Fees	500.00	500.00	1,000.00
Stationary, Printing & Photo Copies	300.00	300.00	300.00
Entertainments	4,200.00	5,000.00	5,000.00
Rents or Rents & Electricity	48,000.00	48,000.00	60,000.00
Staff Salaries & Bonuses	80,000.00	60,000.00	60,000.00
Telephone & Telegram (Fees)	3,500.00	4,000.00	4,000.00
Transportations	5,400.00	5,400.00	5,400.00
Business Registration Fee & Membership Subscription(s)	2,900.00	3,000.00	3,000.00
Cleaning Expenses	5,400.00	6,000.00	6,000.00
Bank Loans/Overdraft Interest Payments	138,560.11	143,485.72	126,698.68
Depreciation	<u>1,743.00</u>	<u>1,321.00</u>	<u>1,006.00</u>
	<u>\$290,503.11</u>	<u>\$277,006.72</u>	<u>\$272,404.68</u>

For convenience we have shown in brackets some changes in nomenclature appearing in the descriptions of certain items in different years.

8. The objections of the Taxpayer to the three assessments were in due course referred to the Deputy Commissioner who by his determination dated 19 September 1991 confirmed the assessments and rejected the objections by the Taxpayer.

9. On 3 October 1991 the Taxpayer appealed to the Board of Review and his appeal was heard in November 1991. The Board of Review after hearing evidence from the Taxpayer by its written decision dated 13 January 1992 found that the Taxpayer had not proved to their satisfaction that he had carried on a trade profession or business in Hong Kong during any of the three years in question and rejected the appeal of the Taxpayer.

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10. On 10 March 1992 the Commissioner gave notice to the Taxpayer informing him that it was proposed to impose penalties under section 82A of the Inland Revenue Ordinance.
11. After considering and taking into account a written representation made by the Taxpayer the Commissioner on 21 April 1992 assessed the Taxpayer to additional tax under section 82(A) in the following amounts:

<u>Year of Assessment</u>	<u>Additional Tax Assessed Section 82(A)</u>
	\$
1986/87	40,000.00
1987/88	34,000.00
1988/89	<u>30,000.00</u>
	Total: <u>\$104,000.00</u>

12. On 19 May 1992 the Taxpayer gave notice of appeal against these three assessments to additional tax.

At the hearing of the appeal the Taxpayer was represented by his tax representative and he himself appeared and gave evidence. His representative submitted that he had a reasonable excuse because the Taxpayer thought that he was entitled to off set the losses of the practice against his wife's income. The submission on behalf of the Taxpayer and the tenor of his evidence was to the effect that he had gone to Country S and during his absence he wished to keep the practice in existence and for this purpose employed staff and incurred the other expenses which he had claimed. The representative said that the Taxpayer thought that he could deduct all of these expenses in respect of his practice which the Taxpayer had always maintained was active and operative. The representative said that notwithstanding the decision of the previous Board of Review the Taxpayer still had a reasonable excuse in applying for personal assessment in respect of his wife's income and in seeking to deduct the expenses of the practice.

At first the Taxpayer indicated that he did not wish to give evidence before the Board but the case was adjourned to enable his tax representative to take his instructions. When the case reconvened the Taxpayer decided that he would give evidence.

At the conclusion of his case the representative for the Taxpayer after making some preliminary points made three submissions. The first was that the Taxpayer staunchly believed that he was still running his business in a scaled down form. The second submission was that the additional penalty assessments should be annulled because they amounted to the reopening of matters which had previously been determined by an earlier Board of Review. The third submission was that the amounts of the penalty assessments

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were excessive and should be substantially reduced taking into account all of the circumstances.

The representative for the Commissioner submitted that the Taxpayer had been given ample opportunity to produce evidence to substantiate the accounts of the practice which he had filed and the alleged expenses which he had incurred. He pointed out that the Taxpayer had not called any witnesses other than himself and had produced no documentary evidence relating to the alleged expenses. He submitted that the Taxpayer had ceased carrying on the practice when he went to Country S and that the accounts of the practice were not true and correct. He then dealt with some of the expenses in detail and closed his submission by requesting the Board to increase the amount of the penalties imposed in the light of the evidence now known to the Board.

We have no hesitation in totally rejecting the evidence given by the Taxpayer. It was at best fanciful. It would appear that the Taxpayer had embarked upon a plan or scheme to minimise his tax liabilities in Hong Kong by claiming totally fictitious expenses. His evidence made it clear that he had little regard for the truth. His memory of events was highly selective and lacking in credible detail. For example he was quite positive that he had employed two assistants to work in his business whilst he was absent in Country S. However he was unable to provide any details of the persons whom he had employed. They were apparently known to him prior to his employing them and he could contact them easily whilst they were employed but he had no idea who they were when subsequently asked for details and particulars. The Taxpayer gave conflicting evidence and had previously given conflicting statements to the assessor with regard to the sums of money paid to his alleged staff and the basis on which they were employed.

The rent which the Taxpayer claimed to have paid was non-existent. In fact his wife was purchasing a residence which was mortgaged to the bank and instalment payments were made. The Taxpayer claimed that some or all of these payments had been paid by him and accordingly could be considered to be some sort of rent. We do not believe that the Taxpayer had any office premises during the three years in question.

The item for transportation was no more than a fictitious figure like other figures which the Taxpayer had created. It was supposed to be money which he had reimbursed to his staff for their travel expenses. However throughout the 3 years the practice had no income to which the travel expenses could relate. In reality these three figures were no more than an attempt by the Taxpayer to pretend that the practice was active and to reduce his liability to tax.

Having heard the Taxpayer give evidence, having reviewed the documents and papers before us we found that the expenses claimed by the Taxpayer were nothing more than figments of his imagination so far as the practice was concerned. We find as a fact that when the Taxpayer went to Country S the practice ceased to exist as a going concern. Whether the Taxpayer re-engaged in business when he returned to Hong Kong we do not know and is not material to this appeal. He returned to Hong Kong after the end of the third year of assessment before us.

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The representative for the Commissioner made application in his submission for the amounts of the penalties to be increased. It is abundantly clear to us that the Commissioner in making the additional assessments under section 82(A) has been far too lenient. The Inland Revenue Ordinance provides that penalties up to three times the amount of tax involved can be imposed and the question which we have considered is whether or not in the present case it would be appropriate to increase the amount of the penalties to the maximum permitted under the Ordinance. What the Taxpayer did in this case was to claim the continuance of a business which had ceased to operate and to invent expenses in an attempt to reduce his liability to tax. The Taxpayer is an intelligent professional man who must have known that what he was doing was wrong. However we have given careful consideration to the submissions made by the tax representative for the Taxpayer and have decided that bearing in mind his submissions it is appropriate that the quantum of the penalties should be increased to amounts equal to two times the tax involved.

Accordingly we direct that the first additional assessment for the year of assessment 1986/87 be increased from \$40,000 to \$133,264, that the second additional assessment for the year of assessment 1987/88 be increased from the sum of \$34,000 to the sum of \$115,512 and the third additional assessment for the year of assessment 1988/89 be increased from the sum of \$30,000 to the sum of \$100,174 making a total in all of \$348,950.