

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D9/91

Penalty tax - failure to inform Commissioner of liability to profits tax - quantum of penalties - failure to notify Commissioner of liability to salaries tax after filing employer's salaries tax return for himself - section 82A of the Inland Revenue Ordinance.

Panel: William Turnbull (chairman), John D Mackie and Ma Ching Yuk.

Date of hearing: 6 March 1991.

Date of decision: 3 May 1991.

The taxpayer carried on business as a sole proprietor and subsequently incorporated the business. He failed to inform the Commissioner that he was liable to business profits tax and the Deputy Commissioner imposed substantial penalties upon him under section 82A. After the incorporation of the business the taxpayer failed to inform the Commissioner that he was receiving income subject to salaries tax but in respect of one of the two years in question he filed on behalf of the employer a salaries tax return form in respect of himself. The Deputy Commissioner imposed penalties under section 82A upon the taxpayer in respect of his failure to notify the Commissioner of his liability to salaries tax. The taxpayer appealed to the Board on the ground that the assessments to penalty tax were excessive.

Held:

The taxpayer had no excuse for failing to inform the Commissioner that he was liable to profits tax and on the facts of this case it was a serious case. Accordingly the penalties of approximately 46% of the permitted maximum were not excessive. With regard to the salaries tax the fact that the taxpayer had filed an employer's tax return in respect of himself might constitute notification to the Commissioner within the meaning of section 51(2) of the Inland Revenue Ordinance. Even if it did not it was not appropriate to impose a penalty upon the taxpayer for failing to notify the Commissioner of his liability to tax when he had informed the Commissioner of his liability in another guise. However with regard to one of the two years in question relating to salaries tax there was no evidence that he had notified the Commissioner either in his own right or as the employer and the penalty imposed which was substantially less than the tax under paid was not excessive.

Appeal allowed in part.

Woo Shu Sum for the Commissioner of Inland Revenue.

Taxpayer in person.

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Decision:

This is an appeal by a taxpayer against a number of penalty tax assessments imposed under section 82A of the Inland Revenue Ordinance for the years of assessment 1982/83 to 1986/87. The facts are as follows:

1. The Taxpayer was the sole proprietor of a business which carried on art design. In 1985 the unincorporated business was incorporated by the Taxpayer who became the managing director of the new company which continued in the same line of business.
2. The Taxpayer did not inform the Commissioner in writing that he was chargeable to profits tax for the years of assessment 1982/83 to 1985/86 and it was claimed by the Commissioner that he had not informed the Commissioner of his liability to salaries tax for the years of assessment 1985/86 and 1986/87 within the four months period after the end of each of the relevant years of assessment as prescribed by section 51(2) of the Inland Revenue Ordinance. However in respect of the company which the Taxpayer had formed the Taxpayer filed a notice with the Commissioner informing the Commissioner of the amount of salary which he had received from the company for the year of assessment 1986/87 and giving notice of the fact that he was employed by the company during that year of assessment.
3. On 18 November 1987 the salaries tax assessor issued to the Taxpayer a salaries tax return for the year of assessment 1986/87. The Taxpayer did not file this return within the one month period permitted.
4. In 1988 the assessor commenced an investigation into the tax affairs of the Taxpayer. On 11 August 1988 the Taxpayer attended an interview with the assessors during which he was told of the tax investigation and was told about the penalty provisions under section 82A of the Inland Revenue Ordinance. At this interview the Taxpayer was also served with a salaries tax return for the year of assessment 1985/86 and a duplicate salaries tax return for the year of assessment 1986/87. On 31 August 1988 the Taxpayer attended another interview with the assessors to further discuss the tax investigation. On 6 September 1988 profits tax returns in respect of the unincorporated business for the years of assessment 1982/83 to 1985/86 were issued to the Taxpayer. The Taxpayer did not file returns within the one month period permitted nor did he apply for any extension of time.
5. On 13 March 1989 in default of receiving from the Taxpayer the profits tax return for the year of assessment 1982/83 the assessor raised an estimated assessment in the amount of \$300,000. By a letter dated 1 April 1989 the Taxpayer objected to this estimated assessment but did not file the profits tax

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return. He was allowed to validate his objection on condition that he filed on or before 17 April 1989 a properly completed return. The return was duly filed on 17 April 1989.

6. On 11 October 1989 in default of receiving from the Taxpayer the salaries tax return for the year of assessment 1986/87, the assessor raised an assessment in the amount of \$100,882 which was in accordance with the information supplied by the Taxpayer himself as a director of his own company which had filed an employer's tax return in respect of himself. On 15 November 1989 the Taxpayer approached the assessor regarding this assessment to salaries tax and filed a duplicate salaries tax return reporting his assessable income and claiming allowances in respect of his wife and child. The salaries tax assessment was revised accordingly.
7. On 8 March 1990 in default of receiving from the Taxpayer the profits tax return for the year of assessment 1983/84 the assessor raised an estimated assessment in the amount of \$500,000. By a letter dated 16 March 1990 the Taxpayer objected to this estimated assessment but without filing the profits tax return. He was permitted to validate his objection on condition that he filed on or before 11 May 1990 a properly completed return. A duplicate return was filed on 10 May 1990.
8. On 5 June 1990 the Taxpayer attended an interview with the assessors when a possible settlement of the tax investigation was discussed and it was agreed that the tax investigation would be settled as follows:

(a) Taxpayer carrying on business

| <u>Year of Assessment</u> | <u>Agreed Assessable Profits</u> |
|---------------------------|----------------------------------|
| | \$ |
| 1982/83 | 90,000 |
| 1983/84 | 90,000 |
| 1984/85 | 200,000 |
| 1985/86 | <u>100,000</u> |
| | 480,000 |
| | ===== |

(b) Taxpayer personally

| <u>Year of Assessment</u> | <u>Agreed Assessable Income</u> |
|---------------------------|---------------------------------|
| | \$ |
| 1985/86 | 130,000 |
| 1986/87 | <u>290,000</u> |
| | 420,000 |
| | ===== |

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9. Based on the agreed assessable profits and agreed assessable income the Taxpayer filed duplicate profits tax returns for the years of assessment 1984/85 and 1985/86 and a duplicate salaries tax return for 1985/86. On 4 July 1990 the assessor revised the profits tax assessments for the years of assessment 1982/83 and 1983/84 and raised profits tax assessments for the years of assessment 1984/85 and 1985/86. A salaries tax assessment for the year of assessment 1985/86 and an additional salaries tax assessment for the year of assessment 1986/87 were also issued.
10. On 10 September 1990 the Deputy Commissioner gave due notice to the Taxpayer informing him that it was proposed to impose penalties under section 82A of the Inland Revenue Ordinance. After receiving written representations the Deputy Commissioner on 12 November 1990 assessed additional tax upon the Taxpayer under section 82A as follows:

(a) Taxpayer carrying on business

| <u>Year of Assessment</u> | <u>Additional Tax</u> \$ |
|---------------------------|-----------------------------|
| 1982/83 | 5,700 |
| 1983/84 | 5,700 |
| 1984/85 | 39,800 |
| 1985/86 | 34,600 |
| | 85,800 |
| | ===== |

(b) Taxpayer personally

| <u>Year of Assessment</u> | <u>Additional Tax</u> \$ |
|---------------------------|-----------------------------|
| 1985/86 | 11,400 |
| 1986/87 | 61,600 |
| | 73,000 |
| | ===== |

11. On 13 December 1990 the Taxpayer gave notice of appeal against these additional tax assessments under section 82B of the Inland Revenue Ordinance.

At the hearing of the appeal the Taxpayer appeared in person. He explained that he had set up the business himself and that he did not mean to hide the facts about his income and profits. He said that he had employed some staff to do the accounting and that the documents provided

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by his staff had been inadequate. He said that as a result he had not been able to fulfil his obligations under the Inland Revenue Ordinance. He said that he had had changes in his staff in the accounts division. He said that he had been busy with the work of his business and had not had any time to attend to other matters. The Taxpayer then submitted that the amounts of the penalties were excessive and that he had agreed to settle the matter with the Inland Revenue Department quickly so as to minimise the penalties.

The representative for the Commissioner said that the penalties were not excessive. He pointed out that the Taxpayer had agreed to settle this matter on the bases of the profits and income which had been assessed and could not now re-open the assessments or revised assessments which had been based on his agreement. He pointed out that it was the statutory obligation of every taxpayer to inform the Commissioner in writing that he is chargeable to tax. He went on to point out that even when the Taxpayer was given tax returns to complete he had failed to file them within the specified times. He said that the Taxpayer had been passive rather than active and had waited for the Inland Revenue Department to take action and find out what was his income rather than volunteering what he had received. He pointed out that by failing in his obligations the Taxpayer had caused the tax to be undercharged and payment to be deferred for a number of years. He said that the possible maximum penalty was \$346,050 and the penalties amounted to only \$158,800 which is no more than 45.89% of the maximum permitted.

This is clearly a serious case. It is no excuse for the Taxpayer to say that he was too busy to attend to his tax affairs. Likewise it is no excuse for him to say that his accounts department staff were not able to maintain his accounts properly and to prepare tax returns for filing. If anything it makes the case more serious because the Taxpayer in his submission indicated that he had an accounts division comprising a number of persons. We also have the problem of the inconsistency in the alleged fact that the Taxpayer did not have adequate accounting records but was able to prepare accounts when he filed tax returns and was also able to prepare detailed accounts for the purpose of this hearing.

On the other hand the Commissioner's representative in the statement of facts prepared for this hearing and in his submission to us did not draw attention to the fact that it was the Taxpayer himself in his capacity as a director of his own company who had drawn the attention of the Inland Revenue Department to the salary which he was receiving from his own company. This places the salaries tax affairs of the Taxpayer in a completely different light. Whilst it is true to say that the Taxpayer had completely failed in his obligations to notify the Commissioner that he was carrying on a business profitably and should be penalised for so doing, it is difficult to say that he has not informed the Commissioner that he was receiving salary when he actually signed an employer's tax return informing the Commissioner of the fact that he was employed by a company and was receiving a salary. Indeed it was based on this return which he filed he was assessed to tax.

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In view of the foregoing and after careful consideration we have decided that the additional penalty tax assessments imposed on the Taxpayer for failing to notify the Commissioner about his business profits are not excessive and should be confirmed and we hereby confirm the same in the total sum of \$85,800.

With regard to the additional penalty tax imposed on the Taxpayer personally for failing to inform the Commissioner of his salaries tax income we consider that on the facts of the case as they have been adduced before us the additional penalty tax assessment for the year of assessment 1986/87 of \$61,600 should not have been made. We do not wish to make a ruling on whether or not the Taxpayer duly notified the Commissioner within the meaning of section 51(2) of the Inland Revenue Ordinance when he filed an employer's tax return in his capacity as director of the company which he managed and which employed him. It is not necessary for us to do this. However, it would appear to us that an argument could be made that he had complied with his obligations under section 51(2). As however neither he nor the Commissioner's representative submitted arguments to us on this point we leave the matter open for a future Board of Review to make a ruling if it ever arises again. However, in considering whether or not the penalty tax is excessive it is clear to us that the tax is excessive and in the circumstances should be reduced to a nil assessment. In relation to this year of assessment the Taxpayer has technically failed to inform the Commissioner of his income liable to salaries tax as a taxpayer. However as a result of the Taxpayer's own wilful act the Commissioner was informed by the Taxpayer and a tax assessment for salaries tax was issued. We also note that the employer's tax return filed by the Taxpayer was filed very promptly within the specified statutory period. In such circumstances we do not think that it is appropriate that any penalty should be imposed upon the Taxpayer and accordingly we order that the assessment for additional penalty tax in respect of the year of assessment 1986/87 of \$61,600 be reduced to nil.

With regard to the additional penalty tax assessment for the year of assessment 1985/86 we were not given any evidence that the Taxpayer had in fact filed an employer's tax return in respect of himself. He said that he thought that he had done so but the representative for the Commissioner was unable to confirm this. It would appear from the facts before us that the first salaries tax assessment which was issued was in respect of the year of assessment 1986/87 and this indicated to us that probably no employer's tax return was filed or filed on time in respect of the year of assessment 1985/86. As the onus of proof is upon the Taxpayer and as we have no evidence before us that the Taxpayer did file an employer's tax return in respect of himself for the year of assessment 1985/86, we find as a fact that the Taxpayer failed to notify the Commissioner of his salaries tax income for that year of assessment. Taking all of the circumstances of this case into account we find that the Taxpayer had no reasonable excuse for not notifying the Commissioner of his income liable to salaries tax for the year of assessment 1985/86 and we also find that the amount of additional penalty tax of \$11,400 is not excessive in the circumstances and we confirm this assessment.

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In summary we confirm all of the assessments against which the Taxpayer has appealed with the exception of the sum of \$61,600 for the year of the assessment 1986/87 which we order to be reduced to nil.