Case No. D103/01

Penalty tax – incorrect salaries tax return – failure to disclose commission from other companies – whether reasonable excuse – sections 51(2) and 82A of the Inland Revenue Ordinance ('IRO') – personal obligation – whether quantum of additional tax excessive.

Panel: Ronny Wong Fook Hum SC (chairman), Man Mo Leung and Paul Mok Yun Lee.

Date of hearing: 4 September 2001.
Date of decision: 20 November 2001.

The appellant is a sales executive of Company A selling Company A motor vehicles. Apart from the income from Company A, she received commission from Company G and Company H for introducing clients to utilize hire purchase facilities and insurance coverage extended by these concerns in the purchase of Company A motor vehicles.

The appellant and the Revenue reached agreement on the income that she omitted in the years of assessment 1994/95 to 1998/99. The appellant omitted to report to the Revenue 51.66% of her total income. The Commissioner imposed additional tax on the appellant. The appellant appealed against those additional tax.

It was the contention of the appellant that she was told that the commission was tax free and she was misled by Company A. The Board was not persuaded and that the so-called trade practice was no more than an arrangement whereby the payer and payee tacitly assumed that the Revenue would not be told about the payment.

Held:

1. Even assuming due discharge of her burden, the Board is of the firm view that the alleged agreement does not afford the appellant with any reasonable excuse. The obligation provided in section 51(2) of the IRO is personal to the appellant. It is no answer to say that she delegated discharge of this obligation to someone who once enjoyed her confidence. She herself is answerable for due performance of the obligation. Her position is all the more untenable in the light of her admission that she took no step to verify the due discharge of her obligation. She did not ask Company A or its associates for evidence that they duly accounted to the Revenue for the tax which she herself had to pay. She did not reveal to the Revenue the payments which

she received via Company N which throws doubts on her assertion that she had no intention to evade tax.

2. The IRO requires all persons liable to be assessed to salaries tax to make true and correct returns of their taxable income. For these reasons, the Board is of the view that the appellant has no reasonable excuse and the Commissioner is justified in exercising her power to levy additional tax on the appellant (D113/95, IRBRD, vol 11, 248 followed).

3. The appellant omitted to report to the Revenue 51.66% of her total income for the years of assessment 1993/94 to 1998/99. She was levied additional tax at an average rate of 65.79% of the tax undercharged. The Revenue had given her due allowance in respect of the alleged assurance by Company A. There is no justification for the Board to interfere (D113/95, IRBRD, vol 11, 248, D57/95, IRBRD, vol 11, 19 considered).

Appeal dismissed.

Cases referred to:

D113/95, IRBRD, vol 11, 248
D57/95, IRBRD, vol 11, 19

Ng Ka Wing Allen for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

Background

1. The Appellant is a sales executive of Company A ('the Company') selling Company A motor vehicles.

2. Between 18 May 1994 and 3 May 1999, the Appellant submitted to the Revenue her tax returns for the years of assessment 1993/94 to 1998/99:

(a) She submitted her 1993/94 return on 18 May 1994. She reported to the Revenue her earnings from the Company at $711,231 and from Company B at

$7,770. She sought to deduct therefrom expenses in respect of mobile phone, car parking, clothes and cosmetics totalling $180,000.

(b) She submitted her 1994/95 return on 18 May 1995. She reported to the Revenue her earnings from the Company at $945,595 and the 'Commission' she received from Company C and Company D in the respective sums of $71,857 and $18,510. She sought to deduct therefrom $180,000 said to be expenses in respect of mobile phones, clothings etc.

(c) She submitted her 1995/96 return on 27 May 1996. She reported to the Revenue her earnings from the Company at $669,871 and the 'Commission' she received from Company C and Company D in the respective sums of $86,241 and $28,475. She sought to deduct therefrom $140,000 said to be expenses in respect of telephone and paging, clothing and meals.

(d) She submitted her 1996/97 return on 7 May 1997. She reported to the Revenue her earnings from the Company at $560,539 and the 'Salary including Bonus' which she received from Company E and Company D in the respective sums of $25,735 and $21,589. She sought to deduct therefrom $170,400 said to be expenses in respect of portable phone, parking, clothes and shoes.

(e) She submitted her 1997/98 return on 24 May 1998. She reported to the Revenue her earnings from the Company at $541,136. She sought to deduct therefrom $79,000 said to be expenses in respect of 'Portable phone and pager; lunch and dinner with clients and clothing'.

(f) She submitted her 1998/99 return on 3 May 1999. She reported to the Revenue her earnings from the Company at $305,741. She sought to deduct therefrom $47,760 said to be expenses in respect of telephone fees, clothings, lunch and dinner.

3. In early 1999, the Revenue commenced an investigation into the earnings of car salesmen in particular the commissions they earned for referring clients to finance companies for hire purchase finance and from insurance companies for insurance coverage. The Company is a member of Group F. Associates of the Company offered hire purchase finance and insurance coverage. Those companies include

(a) In relation to hire purchase finance: Company G.

(b) In relation to insurance coverage:

(i) Company C;

(ii) Company H;

(iii) Company I;

(iv) Company J; and

(v) Company K.

4. The Appellant attended an interview with the Revenue on 22 June 1999. During this interview, the Appellant informed the assessors present that:

(a) She first joined the Company in June 1991. The Company paid her a monthly basic salary, a commission and a year end bonus.

(b) Apart from the income from the Company, she received commission from Company G and Company H for introducing clients to utilise hire purchase facilities and insurance coverage extended by these concerns in the purchase of Company A motor vehicles. She claimed that senior staff of Company G and Company H told her and her colleagues that they were not required to report to the Revenue the commission they received as Company G and Company H would pay the tax on such commission for them.

(c) In order to earn her commission, she had to offer her clients various inducements. Such inducements took a variety of forms including gifts, payment of vehicle licence fees or rebates.

The assessor informed the Appellant at this meeting that the commissions she received from Company G and other insurance companies are assessable to tax. Should she wish to claim any deduction in respect of expenses which she incurred in earning such commissions, she should submit to the Revenue her claim with supporting evidence.

5. The Revenue's investigation prompted various steps being taken by Company H and its associates. According to the Appellant, Mr L, director of Company H, held a meeting with the sales executives of the Company on 11 May 1999. Mr L informed those present that Company H would be reporting to the Revenue the commission earned by the sales executives because of the investigations by the Revenue. On 12 May 1999, Company H sent to those sales representatives 'Notification Paid to Persons Other Than Employees' [Form 56M] for the year ended 31 March 1999. This led to protests from the sales executives who returned those forms to Company H.

6. The sales executives sought legal advice. Their solicitors Messrs Yuen & Partners wrote to Company H on 20 May 1999. Messrs Yuen & Partners asserted that prior to the year of

assessment 1995/96, the sales executives were themselves responsible for tax on the commission they received.

> ' However, we are instructed that starting from the financial year of 1995 to 1996, in order to encourage/give more incentive to the sales representatives of the Company to introduce more business to you (which includes but not limited to our clients), you offered to give each of them the Commission tax free. In brief, you shall be solely responsible to pay profits tax on the Commission to the Inland Revenue Department ... It is your duty to pay profits tax on the Commission and not ours (to pay salaries tax)'.

7. The Company responded by inviting the sales executives to attend a series of meetings with their tax consultant. It was then proposed that the tax consultant be appointed as the collective representative of the sales executives but at the expense of a subsidiary of Group F to negotiate the lowest possible penalty with the Revenue.

8. The Company wrote to the Commissioner on 16 July 1999. The Company asserted that its sales executives do not have 'the intention to under-declare their income in order to avoid paying the appropriate taxes'. The Company urged the Commissioner not to impose any penalty pointing out at the same time that the sales executives had to incur as much as 50% of their commission income in order to facilitate a business transaction.

9. The sales executives pleaded their own case in a letter to the Commissioner dated 27 July 1999. They urged the Commissioner to increase their allowable expenses from 10% to 30%. They further urged the Commissioner not to impose additional tax as 'We have done nothing wrong'. These proposals were rejected by the Commissioner on 26 August 1999. The sales executives enlisted the assistance of Messrs Y C Lau & Co. The Commissioner rejected similar requests advanced by Messrs Y C Lau & Co.

10. In early October 1999, the Commissioner wrote to the Company and its associates seeking their confirmation of the commission arrangement as contended by the sales executives. The Company and its associates denied the existence of any such agreement.

11. On 26 October 1999, the Appellant submitted to the Revenue on a without prejudice basis an income schedule for the years of assessment 1993/94 to 1998/99. The Appellant pointed out that 'There might have additional income but it is small and I cannot remember the exact amount'. This income schedule is incorrect. It omitted a sum of $247,992.4 which the Appellant received as rebates from Company M via Company N, a company owned and controlled by the Appellant's boyfriend.

12. On 22 January 2001, the Appellant and the Revenue reached agreement on the income that she omitted in the years of assessment 1994/95 to 1998/99. The agreed position may be summarised as follows:

Year of assessment	Income before investigation	Income after investigation	Income short returned	Tax undercharged
	$	$	$	$
1993/94	719,002	1,547,991	828,989	109,743
1994/95	1,035,962	2,020,843	984,881	130,461
1995/96	784,587	1,713,095	928,508	121,405
1996/97	607,863	1,104,572	496,709	64,379
1997/98	541,136	1,124,512	583,376	74,159
1998/99	305,741	752,707	446,966	67,354
Total	3,994,291	8,263,720	4,269,429	567,501

On the basis of these figures, the Appellant omitted to report to the Revenue 51.66% of her total income for the years of assessment 1993/94 to 1998/99.

13. By notice under section 82A(4) of the IRO dated 14 March 2001, the Commissioner informed the Appellant of his intention to impose additional tax. After considering representations from the Appellant dated 12 April 2001, the Commissioner by notices dated 23 May 2001 imposed additional tax on the Appellant in sums set out hereunder:

Year of assessment	Income before investigation	Income after investigation	Income short returned	Tax undercharged	Additional tax imposed	Relationship between additional tax imposed and tax undercharged
	$	$	$	$	$	%
1993/94	719,002	1,547,991	828,989	109,743	82,000	74.72
1994/95	1,035,962	2,020,843	984,881	130,461	97,000	74.35
1995/96	784,587	1,713,095	928,508	121,405	89,000	73.31
1996/97	607,863	1,104,572	496,709	64,379	42,000	65.24
1997/98	541,136	1,124,512	583,376	74,159	42,000	56.64
1998/99	305,741	752,707	446,966	67,354	34,000	50.48
Total	3,994,291	8,263,720	4,269,429	567,501	386,000	Average of 65.79

14. This is the Appellant's appeal against those assessments.

The relevant provisions in the IRO

15. Section 82A of the IRO provides that:

> ‘ *(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, ...*
>
> *(b) ...*
>
> *(c) ...*
>
> *(d) ...*
>
> *(e) ...*
>
> *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 ... or would have been so undercharged if the return ... had been accepted as correct; or*
>
> *(ii) ...’*

16. Section 82B(2) of the IRO provides that:

> ‘ *On an appeal against assessment to additional tax, it shall be open to the appellant to argue that –*
>
> *(a) he is not liable to additional tax;*
>
> *(b) the amount of additional tax assessed on him exceeds the amount for which he is liable under section 82A;*
>
> *(c) the amount of additional tax , although not in excess of that for which he is liable under section 82A, is excessive having regard to the circumstances.’*

17. There are therefore two issues before us:

(a) Is the Appellant liable to additional tax? This in turn depends on whether the Appellant has a 'reasonable excuse' within the meaning of section 82A of the IRO.

(b) If the Appellant is so liable, is the amount of additional tax excessive having regard to the circumstances?

Reasonable excuse

18. The Appellant's case is a confusing one. She tried hard to maintain that she is not liable to additional tax as she was supposed to receive the commission tax free. It is not clear what precisely the basis of that contention is. There are several possibilities:

(a) first, she is not liable by virtue of an undertaking by the Company that the Company would shoulder the tax burden;

(b) secondly, she is not liable by virtue of an undertaking by each of the paying companies that each would shoulder the tax burden;

(c) finally, she is not liable by virtue of the practice of the motor industry that all paying companies would shoulder the tax burden.

19. According to the sworn testimony of the Appellant:

(a) She left school after Form V and had working experience with a bank and a stockbroker.

(b) When she first joined the Company, she was told that all hire purchases had to be routed to Company G. She was told that she would receive tax free commission. It was unnecessary for her to report the same to the Revenue. It was further suggested to her that she should use the commission paid for the purpose of entertaining her clients.

(c) She had no intention of evading her tax liability. She had faith in the Company. She was misled by the Company.

(d) She did not seek any verification in relation to her arrangement with the Company between 1992 and 1999.

(e) A colleague was killed in the course of a homicide. The police probed into the financial dealings of that colleague. The Revenue became involved as a result of such investigation.

(f) Company N was established by her boyfriend. Company N assumed the role of a dealer for clients who wished to avail themselves of Company M's hire purchase facilities.

20. The Appellant is an eloquent witness who is convinced of the legitimacy of her own case. Unfortunately, when her case is closely examined, we find her case wholly devoid of particulars as to the time, place, persons present and terms of any agreement reached. According to the letter of her solicitors Messrs Yuen & Partners dated 20 May 1999, there was a separate agreement with Company H which came into force in the financial year 1995/96. Apart from Company H and the Company, it is not clear what the basis of her arrangement with companies such as Company I, Company J and Company K was. Her case is particularly perplexing in relation to payments she received from Company N. Did she reach an agreement with Company M or were the payments made pursuant to an alleged practice amongst the motor industry? We entertain serious reservations in relation to this alleged trade practice. We are not persuaded that the so-called trade practice was no more than an arrangement whereby the payer and payee both tacitly assumed that the Revenue would not be told about the payment. We have taken into account the emotional confrontation between the sales executives and the Company and the rather timid stance taken by the Company against the assertions of its employees. Whilst we do not find the denials of the Company and its associates convincing, we are not satisfied that the Appellant has established before us the alleged agreement which forms the backbone of her case.

21. Even assuming due discharge of her burden, we are of the firm view that the alleged agreement does not afford the Appellant with any reasonable excuse. Her obligation vis-à-vis the Revenue is clear. It is to be found in section 51(2) of the IRO which provides:

> ' *Every person chargeable to tax for any year of assessment shall inform the Commissioner in writing that he is so chargeable not later than 4 months after the end of the basis period for that year of assessment...'*

This obligation is personal to the Appellant. It is no answer to say that she delegated discharge of this obligation to someone who once enjoyed her confidence. She herself is answerable for due performance of the obligation. Her position is all the more untenable in the light of her admission that she took no step to verify the due discharge of her obligation. She did not ask the Company or its associates for evidence that they duly accounted to the Revenue for the tax which she herself had to pay. She did not reveal to the Revenue the payments which she received via Company N which throws doubts on her assertion that she had no intention to evade tax.

22. We are of the view that the Appellant's position is no different from that of the taxpayer in D113/95, IRBRD, vol 11, 248 cited by the Revenue. The taxpayer in that case was also a salesman. After investigation into his tax affairs, the assesssor discovered that he did not report his total income and he had not filed his salaries tax return for three years. He explained to the Board

that he had been working for his brothers in the family company as requested by his mother. He said that he had acted as he had been told by his brother. Because he was the youngest son he had to be obedient to his elder brother who had said that he would take care of tax matters. The Board said this in rejecting his case:

> *' The Board has much sympathy for the Taxpayer in this case. It fully understands the obligations and duties placed upon him as the youngest son of a family. However that does not excuse what he did or failed to do. The Inland Revenue Ordinance is quite clear and precise. It requires all persons liable to be assessed to salaries tax to make true and correct returns of their taxable income. This the taxpayer failed to do. Indeed in three years in question he failed to file any tax returns at all.'*

23. For these reasons, we are of the view that the Appellant has no reasonable excuse and the Commissioner is justified in exercising her power to levy additional tax on the Appellant.

The amount of additional tax

24. Mr Ng for the Revenue explained to us the basis of the Commissioner's assessment in the light of the guidelines recently promulgated by the Revenue. Mr Ng pointed out that there was no voluntary disclosure by the Appellant. Her liability was revealed after investigation. The Appellant's failure was not confined to one year but was a persistent one extending over several tax years. Bearing in mind the possibility that the Appellant might have been misled by the Company and its associates, the Commissioner decided that her case should fall into sub-group (b) in the second column of the Revenue's guidelines where additional tax would be levied at 50% to 75% of the tax undercharged.

25. Mr Ng also drew our attention to the following decisions of this Board:

(a) In D57/95, IRBRD, vol 11, 19, the taxpayer was a salesman in a retail shop and he completed salaries tax returns based on incorrect information provided by his employer. The information did not include his commission which was a very significant part of his total emolument. The Board pointed out that in a case of this nature the starting point for assessing penalties was 100% of the amount of tax that would have been undercharged. The Board however accepted that the erroneous declaration by the employer was an important mitigating fact and confirmed additional tax levied at the average rate of 70% of the tax undercharged.

(b) In D113/95 (above cited), the Board approved additional tax levied at an average rate of 74% of the tax undercharged on a salesman who failed to make

proper return by virtue of his elder brother's assurance that he would take care of tax matters.

26. The Appellant omitted to report to the Revenue 51.66% of her total income for the years of assessment 1993/94 to 1998/99. She was levied additional tax at an average rate of 65.79% of the tax undercharged. The Revenue had given her due allowance in respect of the alleged assurance by the Company. There is no justification for us to interfere.

27. For these reasons, we dismiss the Appellant's appeal.