INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D110/01

Penalty tax – tax return – omit to report income from sale commissions – appellant dishonest – additional tax levied at 100% of the tax undercharged – sections 51(2), 68(8), 82A and 82B of the Inland Revenue Ordinance ('IRO').

Panel: Ronny Wong Fook Hum SC (chairman), Francis Lui Yiu Tung and Ronald Tong Wui Tung.

Date of hearing: 22 September 2001.
Date of decision: 27 November 2001.

The appellant was a sales executive selling motor vehicles. By his tax returns he reported to the Revenue that his income for six years of assessment was $6,694,403. The Revenue commenced investigation.

The appellant admitted during an interview with the Revenue that he failed to report to the Revenue commissions he received. He said that salesmen working for other motor companies likewise did not report to the Revenue the commissions they received. Subsequently the appellant submitted to the Revenue on a without prejudice basis an income schedule for the years of assessment concerned. However, the appellant asserted in the schedule a statement which was grossly misleading. Further investigations by the Revenue uncovered payments which the appellant received from other entities. The appellant omitted to report to the Revenue 63% of his total income for the years of assessment concerned.

Held:

1. The appellant's obligation vis-à-vis the Revenue is clear. It is to be found in section 51(2) of the IRO. This obligation is personal to the appellant. It is no answer to say that the appellant delegated discharge of this obligation to someone who once enjoyed his confidence. The Commissioner was justified in exercising her power to levy additional tax on the appellant.

2. The Board was of the view that the appellant was dishonest in his dealings with the Revenue. The appellant failed to report income in the sum of $11,354,087 for the years of assessment concerned. It amounted to 63% of his income for those years. There was insufficient justification in this case to depart from the starting point of additional tax being levied at 100% of the tax undercharged.

Appeal dismissed.

Cases referred to:

D113/95, IRBRD, vol 11, 248
D57/95, IRBRD, vol 11, 19
D53/88, IRBRD, vol 4, 10
D179/98, IRBRD, vol 14, 78

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

Decision:

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

2. Between 15 October 1994 and 5 May 1999, the Appellant submitted to the Revenue his tax returns for the years of assessment 1993/94 to 1998/99:

(a) He submitted his 1993/94 return on 15 October 1994. He reported to the Revenue his earnings at $912,006 and his earnings from Company B at $9,090. He sought to deduct therefrom expenses in respect of transportation, car parking, clothing, meals and entertainment totalling $200,000.

(b) He submitted his 1994/95 return on 31 May 1995. He reported to the Revenue his earnings from the Company at $1,223,347 and his earnings from Company C, Company D and Company E in the respective sums of $79,798, $3,409 and $14,582. He sought to deduct therefrom $400,000 said to be expenses in respect of meals and transportation etc.

(c) He submitted her 1995/96 return on 6 May 1996. He reported to the Revenue his earnings at $1,223,347 without identifying his source. He sought to deduct therefrom various expenses amounting to $268,000.

(d) He submitted her 1996/97 return on 1 May 1997. He reported to the Revenue his earnings at $964,837 without identifying his source. He sought to deduct therefrom $206,000 said to be expenses incurred and fees paid during that year.

(e) He submitted his 1997/98 return on 2 May 1998. He reported to the Revenue his earnings at $1,149,682. Once again, he did not identify his source. He sought to deduct therefrom $540,000 said to be expenses incurred in that year. The expenses were said to have been made up as follows:

(i) Car parking: $60,000.

(ii) Entertainment: $200,000.

(iii) Repair of motor vehicle: $60,000.

(iv) Clothing: $60,000.

(v) Transportation and fuel: $100,000.

(vi) Telephone: $60,000.

(f) He submitted his 1998/99 return on 3 May 1999. He reported to the Revenue his earnings from the Company at $1,005,784. He sought to deduct therefrom $400,000 said to be expenses in respect of company car park, clients' entertainment, transportation, clothing and portable telephone.

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 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 D;

(iii) Company H;

(iv) Company I; and

(v) Company J.

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

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

(b) He admitted that as from 1995 he failed to report to the Revenue the commissions he received from the insurance companies.

(c) He also admitted that he had omitted to include the commissions from Company G and Company H as he was told by staff working for those two companies that no tax was payable thereon. He said that salesmen working for other motor companies likewise did not report the commissions they received to the Revenue.

(d) In order to earn his commission, he had to offer his clients various inducements. Such inducements took a variety of forms including rebates, supply of spare parts or gifts.

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

5. The Revenue's investigation prompted various steps being taken by Company H and its associates. According to the Appellant, Mr K, director of Company H, held a meeting with the sales executives of the Company on 11 May 1999. Mr K 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 executives '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 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.

8. 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.

9. On 28 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 asserted in that schedule that 'I confirm that I did not receive any income including commissions, loan originating fees, rebates, etc from other finance company(ies) and/or other insurance company(ies) and/or other person(s) during the period from 1 April 1993 to 31 March 1999'. This statement is grossly misleading.

10. Further investigations by the Revenue revealed the following:

(a) Company L is a company incorporated in Hong Kong on 29 September 1989. At all material times, Company L is a company controlled by the Appellant.

(b) Company L referred lease and hire purchase financing business in respect of brand new Company A motor vehicles to Company M. Company M paid Company L commission for such referrals. In about July 1994, Company L opened an account with Company M. Company M credited into this account the commissions due.

(c) On 13 April 1996, the Appellant submitted to the Revenue Company L's return for the year of assessment 1995/96. The Appellant asserted that Company L had not commenced any business.

(d) By letter dated 3 January 2000, Company M informed the Revenue the substantial commission which they paid Company L between 1994 and 1999.

11. The Revenue also uncovered payments which the Appellant received from other entities. These include Company N, Company O and others.

12. On 19 January 2001, the Appellant and the Revenue reached agreement on the income that he 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	984,719	2,487,693	1,502,974	199,380
1994/95	1,321,136	3,326,925	2,005,789	266,284
1995/96	1,268,245	3,575,419	2,307,174	307,764
1996/97	964,837	2,516,918	1,552,081	206,878
1997/98	1,149,682	3,188,686	2,039,004	245,226
1998/99	1,005,784	2,952,849	1,947,065	285,809
Total	6,694,403	18,048,490	11,354,087	1,511,341

On the basis of these figures, the Appellant omitted to report to the Revenue 63% of his 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 19 April 2001, the Commissioner by notices dated 21 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	984,719	2,487,693	1,502,974	199,380	171,000	85.76
1994/95	1,321,136	3,326,925	2,005,789	266,284	229,000	85.99
1995/96	1,268,245	3,575,419	2,307,174	307,764	265,000	86.10
1996/97	964,837	2,516,918	1,552,081	206,878	161,000	77.82
1997/98	1,149,682	3,188,686	2,039,004	245,226	168,000	68.71
1998/99	1,005,784	2,952,849	1,947,065	285,809	172,000	60.18
Total	6,694,403	18,048,490	11,354,087	1,511,341	1,166,500	77.18

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. According to the testimony of the Appellant:

(a) He was told by Company G, Company H and Company M that it was unnecessary for him to report to the Revenue the commission which he received as those companies had accounted to the Revenue on his behalf. He had no reason to doubt the words of these companies.

(b) He did not seek any verification from any of these companies. He also did not approach the Revenue for confirmation. He did not approach any solicitor or accountant for advice as to the proprietary of such arrangement.

(c) 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.

(d) He did not disclose to the Revenue his interests in Company L as he thought the investigation was confined to his dealings with the Company. He informed the Revenue that Company L had not commenced business as it did not occur to him that Company L was actually carrying on a business.

(e) He did not reveal his receipts from Company O as they gave him business.

19. We are of the view that the Appellant was dishonest in his dealings with the Revenue. We reject his explanation in relation to Company L and Company O. Had there been any agreement between him and Company M, one would expect him to report to the Revenue his receipts from Company M and the alleged undertaking of Company M to discharge all tax payable on the commission of Company L. To inform the Revenue that Company L had not commenced business is a deliberate concealment which throws doubt on any alleged promise on the part of Company M. 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, the Appellant had not given any evidence that could establish with precision the alleged agreement which forms the backbone of his case.

20. Even assuming due discharge of his burden, we are of the firm view that the alleged agreement does not afford the Appellant with any reasonable excuse. His 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 he delegated discharge of this obligation to someone who once enjoyed his confidence. He himself is answerable for due performance of the obligation. His position is all the more untenable in the light of his admission that he took no step to verify the due discharge of his obligation. He did not ask the Company or its associates for evidence that they duly accounted to the Revenue for the tax which he himself had to pay. He was totally dishonest in relation to Company L and Company O.

21. We are of the view that the Appellant's position is much worse than 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 assessor 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.*'

22. 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

23. 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. His liability was revealed after investigation. The Appellant's failure was not confined to one tax 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 his 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.

24. 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.

25. The Appellant failed to report income in the sum of $11,354,087 for the years of assessment 1993/94 to 1998/99. This amounted to 63% of his income for those years. The ommission is a substantial one. He was dishonest in relation to Company L, seeking to conceal about $1,800,000 commission he received through that company. Whilst the concealment in relation to Company O is much less, it casts further doubts on the Appellant' s bona fide. We have no sympathy with any argument that the Appellant' s position might have been prejudiced due to his inability to claim any deduction in respect of these commissions. The Revenue had been extremely generous in allowing the Appellant' s extravagant claims for deductions in the relevant tax years.

26. In these circumstances, bearing in mind our express finding of dishonesty on the part of the Appellant, we entertain serious reservation whether there is insufficient justification for the Revenue to depart from the 100% level established by this Board in cases like D53/88, IRBRD, vol 4, 10 and D179/98, IRBRD, vol 14, 78 in relation to income concealed through such dishonesty. We would like to consider whether we should exercise our power under sections 82B(3) and 68(8) of the IRO and increase the assessment of additional tax for the relevant years to reflect this finding. We would give the following directions for further submissions by both parties on this particular issue:

(a) Within 14 days from the date of despatch of this decision, the Respondent shall send a proposed revised assessment to the Appellant and to this Board to reflect our ruling in this paragragh setting out the basis of computation.

(b) Within seven days from date of despatch of the Respondent's proposed revised assessment, the Appellant shall notify the clerk of this Board whether he would like to convene a hearing by this Board on this issue or whether he would be content to make written submissions for consideration by this Board. Should he decide to adopt the latter course, his written submissions should be sent to this Board with copy to the Respondent within 21 days from date of despatch of the Respondent's proposed revised assessment.

Decision:

1. We refer to our decision dated 27 November 2001 where we set out the issues between the Appellant and the Revenue. We expressed our reservations on the level of penalty imposed bearing in mind our finding of dishonesty against the Appellant. We invited the Appellant to make submission as to why we should not exercise our power and revise the assessments to 100% of the tax undercharged.

2. By letter dated 12 December 2001, the Appellant submitted that:

(a) there was no dishonesty on his part. He was misled by the relevant financial institutions;

(b) he did not report his commission by virtue of the assurances given to him by Mr K, a director of Company H;

(c) he incurred substantial expenses in the production of his income and the Revenue only allowed him deductions to the extent of 10% of his income; and

(d) he and his colleagues were advised by their professional advisers that no additional tax would be chargeable against them.

3. There is nothing new in these factors which were extensively debated in the hearing before us on 22 September 2001 and which we discussed at length in our 27 November 2001 decision. We remain of the view that there is insufficient justification in this case to depart from the 100% starting point. We direct that the additional tax assessments for the years of assessment 1993/94 to 1998/99 be revised to that level.