

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D112/95

**Penalty tax** – filing incorrect profits tax returns – additional tax – whether excessive – section 82A of Inland Revenue Ordinance.

Panel: William Turnbull (chairman), Peter F Rhodes and So Kai Ming.

Date of hearing: 9 January 1996.

Date of decision: 14 February 1996.

The taxpayer was the sole proprietor of a jewellery business. The profits tax returns for the years of assessment 1984/85 to 1988/89 were submitted by the taxpayer. The assessor commenced investigations, and found out that the actual profits of the taxpayer should be \$1,587,723 whilst those submitted were only \$359,085. The tax understated was \$230,000 in total. The Commissioner demanded for additional tax which was 149%, on average, of the tax undercharged, for each year of assessment.

The taxpayer appealed on the grounds that the additional tax was unreasonable and argued that, inter alia, he relied on his staff to file the tax returns for him.

Held:

The Inland Revenue Ordinance requires all taxpayers to maintain true and correct accounts of their business. This the taxpayer failed to do. It is no excuse to say that the proprietor of a business delegated these obligations to his staff. The Board does not consider that the penalties imposed which come to a total of 149% of the tax undercharged are excessive.

**Appeal dismissed.**

Case referred to:

D71/91, IRBRD, vol 7, 1

Li Mak Sin Ming for the Commissioner of Inland Revenue.

Taxpayer in person.

**Decision:**

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This is an appeal by a Taxpayer carrying on business against a number of additional tax assessments for the years of assessment 1984/85 to 1988/89 raised upon him under section 82A of the Inland Revenue Ordinance (the Ordinance). The facts are as follows:

1. At all material time, the Taxpayer was the sole proprietor of a jewellery business (the Business) which commenced business on 15 November 1983.
2. Profits tax returns for years of assessment 1984/85 to 1988/89 submitted by the Taxpayer in respect of the Business showed the following particulars:

<b>Year of Assessment</b>	<b>Date of Filing Return</b>	<b>Basic Period</b>	<b>Return Profit/(Loss) \$</b>
1984/85	30-10-85	Year ended 31-3-1985	(29,442)
1985/86	12-6-86	Year ended 31-3-1986	13,318
1986/87	30-6-87	Year ended 31-3-1987	75,686
1987/88	20-7-88	Year ended 31-3-1988	152,982
1988/89	24-1-90	Year ended 31-3-1989	131,124

3. The assessor commenced an investigation into the tax affairs of the Taxpayer and interviewed him on 29 August 1990. During the interview, the Taxpayer disclosed inter alia, that:
  - (a) his mother passed away in 1984 and he received legacy including a property in Place A, over 100 taels of 99 gold bars and cash of \$200,000 to \$300,000;
  - (b) his mother did not have any bank accounts and all money and gold bars were kept in a safe deposit box opened in the name of the Taxpayer's elder sister;
  - (c) no affidavit was filed for his mother's estate with the Estate Duty Office;
  - (d) the cash of \$200,000 - \$300,000 was withdrawn by him over 2-3 times and were deposited into his own savings account. The gold bars were used in the Business and charged as purchases in the accounts.

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- (e) the business premises were purchased in April 1988 at \$480,000. The downpayment of \$100,000 odd was borrowed from his youngest sister's schoolmate and the monthly mortgage repayment was \$4,100;
  - (f) the Taxpayer was the major shareholder of X Ltd which acquired an investment property in Place B in early 1989 at \$1,600,000. The downpayment of \$320,000 was borrowed from his major client and the monthly mortgage repayment was \$17,813. The property was let at \$14,000 per month;
  - (g) his sister (the sister) worked in the Business and her salary was over \$4,000 per month with year-end bonus;
  - (h) he and the sister had jointly purchased a property at Place C in 1988 and all purchase consideration was paid by the sister.
4. By a letter dated 17 September 1990, the assessor asked the Taxpayer to furnish further information. Having failed to receive the Taxpayer's reply, the assessor issued a reminder on 20 February 1991.
5. On 15 April 1991, the assessor received a reply dated 17 October 1990 from the Taxpayer which disclosed, inter alia, that:
- (a) he received legacy from his mother in 1984 which comprised around 100 taels of 99 gold bars and cash of \$300,000;
  - (b) he borrowed \$130,000 in 1984 and \$100,000 in 1989 from a Ms A. Monthly repayment for this loan was \$5,500;
  - (c) he borrowed \$200,000 from B at unknown date. Balance still outstanding was \$50,000;
  - (d) he borrowed \$400,000 from C in January 1989;
  - (e) his estimated private and living expenses for the years of assessment 1984/85 to 1989/90 were as follows:

<b>Year of Assessment</b>	<b>Amount of living expenses per year</b> \$
1984/85	85,200
1985/86	135,600
1986/87	140,400

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1987/88	175,200
1988/89	183,600
1989/90	214,800

The Taxpayer did not provide evidence of the loans from various parties as required by the assessor.

6. The assessor was of the opinion that the known sources of income were insufficient to finance the Taxpayer's family living expenses and the mortgage and loan repayments and proceeded to obtain information to compile an Assets Betterment Statement (ABS) for the Taxpayer.
7. On divers dates the assessor raised on the Taxpayer the following profits tax assessments in respect of the Business:

<b>Year of Assessment</b>	<b>Assessable Profits</b>
	\$
1984/85	350,000
1985/86	350,000 (Additional)
1986/87	350,000 (Additional)
1987/88	400,000 (Additional)

The Taxpayer lodged objection against the above assessments and elected to be assessed under personal assessment for all years.

8. On 26 July 1993, the Taxpayer attended another interview with the assessor. Contrary to the information provided during the interview on 29 August 1990 (Fact 3), the Taxpayer disclosed during the interview that the monthly instalments of the property at Place C which he jointly bought with his sister were paid by him. He suggested that the mortgage repayments he paid for his sister be assessed as profits of the business. He also agreed to provide details of loans from Ms A.
9. Having failed to receive the further information which the Taxpayer promised to provide during the interview on 26 July 1993, the assessor made several telephone calls to the Taxpayer to follow up the enquiry. The following is a summary of the notes of the telephone calls:

<b>Date</b>	<b>Answer</b>
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- 14-9-1993                      The Taxpayer said the information would be ready by the end of September. (Nothing was however received)
- 12-11-1993                    The Taxpayer was not in Hong Kong.
- 29-12-1993                    The Taxpayer was not in Hong Kong. Message left for the Taxpayer to call back. (No response)
- 4-1-1994 (10:55 a.m.)      The Taxpayer was engaged in another telephone call. Message left for the Taxpayer to call back. (No response)
- 4-1-1994 (3:30 p.m.)      The Taxpayer was not in the office. The Taxpayer later called back and said the information would be submitted by 15.1.1994. (Nothing received)
- 24-1-1994                      The Taxpayer was not in Hong Kong.
- 18-2-1994                      The Taxpayer said the information would be submitted in the following week. (Again nothing was received)

10. In the course of investigation, the assessor found that the Taxpayer had disposed of all the landed properties in his personal name. The following is a summary of the properties sold during the course of the investigation:

Location of Property	Bought		Sold	
	Date	Price \$	Date	Price \$
Place C (50%)	25-6-1988	769,000	9-10-1993	2,790,000
Place D	12-4-1988	500,000	15-11-1993	4,300,000
Place E	5-11-1992	1,289,000	26-7-1993	1,530,000

11. Knowing that the Taxpayer had disposed of his landed properties, the assessor on 24 August 1994 raised on the Taxpayer estimated profits tax assessments in respect of the Business for the years of assessment 1988/89 to 1992/93. Details of the assessment for the year of assessment 1988/89 are as follows:

Estimated Assessable Profits                      \$600,000

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No objection was received within the one-month objection period prescribed under the Ordinance.

12. On 21 October 1994, the Taxpayer attended another interview with the assessors. During the interview, the Taxpayer disclosed, inter alia, that:
  - (a) he had asked his accountant to lodge objections to the estimated assessments raised on 24 August 1994. The assessor advised that no objection letter or outstanding profits tax returns had ever been received;
  - (b) the business premises at Place D had been sold for \$4,300,000. The Taxpayer received \$3,000,000 odd after repaying mortgage in full;
  - (c) another business premises were acquired under the name of a limited company for \$2,000,000 odd. A few hundred thousand dollars was spent on decoration;
  - (d) he operated a workshop and office in Country X since early 1994. A staff was employed to look after the workshop cum office there;
  - (e) even though he was the registered owner of a property at Place E, he claimed that the source of finance came from a Mr K. This property was later disposed of and no profit was shared by him. No further details or evidence was produced by the Taxpayer;
  - (f) the joint property at Place C was disposed of and the sale proceeds after repaying the mortgage in full were shared by the Taxpayer and the sister in equal shares. Part of the Taxpayer's share was used to repay a loan he previously borrowed through the sister;
  - (g) the property at Place B acquired in name of X Limited was occupied by the Taxpayer as his residence since 1992;
  - (h) he acquired a second hand car, a BMW for \$300,000 odd in September 1992. Monthly instalment payable was \$7,800. The car was recently disposed of;

A list of required information was given to the Taxpayer at the end of the interview.

13. On 23 November 1994, the assessor received a letter dated 20 September 1994 objecting against the assessments issued on 24 August 1994, including the year

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of assessment 1988/89. By a letter on 6 December 1994, the assessor rejected the objection on the ground that the objection was out of time.

14. the Assessor had since compiled an ABS from the bank passbooks and bank statements of the Taxpayer and from other relevant information covering the period from 1 April 1984 to 31 March 1989. The ABS, which showed a total discrepancy of \$2,228,537, was issued to the Taxpayer for representations on 27 February 1995.
15. On the basis of the ABS, the assessor raised on the Taxpayer the following additional assessment for the year of assessment 1988/89 in respect of the Business on 7 March 1995:

Additional Assessable Profits	\$700,000
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The Taxpayer lodged objection against the above assessment and applied for late objections against the assessments issued on 24 August 1994. Having considered the Taxpayer's ground of late objection, the Commissioner accepted the objections against the 1988/89 assessments.

16. By a letter dated 20 March 1995, the Taxpayer made representations to the ABS claiming the following deductions:
  - (a) his financial support from the year 1985 to 1989 came from his mother's legacy and loan from his friends but not from his business;
  - (b) the unidentified bank withdrawals for the year 1989 in total amount of \$899,899 were made to suppliers in settlement of accounts payable upon purchases of the business. The relevant invoices would be submitted to substantiate this claim.
17. On 12 April 1995, the Taxpayer attended an interview with the assessors to discuss the ABS. After compromising the deduction of certain sums including opening assets of \$100,000 and unidentified bank withdrawals of \$899,899, the Taxpayer accepted the revised discrepancy of \$1,228,638 with revised betterment profits at \$1,587,723 as a basis of settlement. He signified his acceptance of the basis in settlement of the objection to the assessments for the years of assessment 1984/85 to 1988/89 by signing the settlement agreement and the revised ABS on the spot after the content of both documents was explained to him. The assessors reminded him of the penal provisions of the Inland Revenue Ordinance which prescribes that the maximum amount of penalties is three times the tax undercharged. A photocopy of the signed revised ABS and settlement agreement were given to the Taxpayer for record.

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18. On the basis of the agreement reached, revised assessments/additional assessments for the years of assessment 1984/85 to 1988/89 inclusive were issued as follows:

<b>Year of Assessment</b>	<b>Revised Assessable Profits/ Additional Profits \$</b>
1984/85	348,482
1985/86	250,798 (Revised Additional)
1986/87	47,719 (Revised Additional)
1987/88	189,318 (Revised Additional)
1988/89	508,570

19. The following is a comparative table of the Taxpayer's assessable profits before and after investigation and the amount of tax undercharged in consequence of the submission of incorrect returns for years of assessment 1984/85 to 1988/89:

<b>Year of Assessment</b>	<b>Assessed Profits/(Loss) Before Investigation \$</b>	<b>Profits After Investigation \$</b>	<b>Profits Understated \$</b>	<b>Loss Overclaimed \$</b>	<b>Tax Undercharged \$</b>
1984/85	(14,875)	348,482	348,482	(14,875)	59,241
1985/86	14,168	264,966	250,798	-	43,991
1986/87	75,686	123,405	47,719	-	6,681
1987/88	152,982	342,300	189,318	-	44,909
1988/89	<u>131,124</u>	<u>508,570</u>	<u>377,446</u>	<u>-</u>	<u>75,478</u>
	359,085 =====	1,587,723 =====	1,213,763 =====	(14,875) =====	230,300 =====

The percentage of profits understated to total profits assessed after investigation is 77.38%.

20. By a notice dated 22 June 1995, the Commissioner of Inland Revenue gave notice to the Taxpayer under the terms of section 82A(4) of the Ordinance that



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he proposed to assess the Taxpayer to additional tax in respect of the years of assessment 1984/85 to 1988/89.

21. By letter dated 21 July 1995, the Taxpayer submitted a letter requesting for delay of tax payment without making any representation to the proposed assessment of additional tax.
22. By letter dated 9 August 1995, the Taxpayer submitted written representations to the Commissioner pursuant to section 82A(a)(iii).
23. Having considered and taken into account the Taxpayer's representations, the Commissioner, on 7 September 1995, issued notices of assessment and demand for additional tax under section 82A for the years of assessment 1984/85 to 1988/89 to the Taxpayer. The following is a summary of the amounts of additional tax assessed on the Taxpayer:

Year of Assessment	Tax Undercharged \$	Section 82A Additional Tax \$	Additional Tax as percentage of Tax Undercharged
1984/85	59,241	88,000	148%
1985/86	43,991	66,000	150%
1986/87	6,681	10,000	149%
1987/88	44,909	67,000	149%
1988/89	<u>75,478</u>	<u>112,000</u>	148%
	230,300 =====	343,000 =====	149%

24. By letter dated 5 October 1995, the Taxpayer gave notice of appeal to the Board of Review against the above assessments to the additional tax.

The Taxpayer duly appeared before the Board for the hearing of the appeal. He informed the Board that he was not satisfied with the assessments raised by the Inland Revenue Department because they were not based on the actual situation. He said that he had started his career as an office boy and had no experience of running a business. He said that he did not have the funds to start a business and when he began his business he had to secure loans from family members or customers of his former employer. The first three years of his business had been difficult until he secured a major customer. Then he had more orders for processing jewellery but the prices were very low. He was not good at managing his workshop and his workers made a lot of mistakes and he could not meet the

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demands of his customers. For this reason the first three years of his business depended upon a legacy which he received when his mother died.

He went on to say that he wanted to expand his business and made a lot of mistakes buying stock and not being able to find customers to purchase the stock from him. He said that many of the items purchased by him were financed by banks.

He said that he was not familiar with tax and book-keeping. He relied on his staff to sort out the documents and file tax returns for him. He said that no one who is making profit from his business loses credit with the banks. He then went on to say that the Hong Kong tax rates are the lowest in the world and that his future is more important to him than tax.

He then referred to the Inland Revenue Department making enquiries into his accounts since 1984 and that he had tried to provide them with all of the information which he had. He said that last year he had mortgaged a flat to a finance company to repay a loan but the money was not sufficient and because it was a finance company the interest was very high. He then said that when he sold the flat he bought a smaller flat in Place F but did not complete the purchase and forfeited the deposit of \$180,000. He produced copies of lawyer's letters demanding payment of moneys from him to demonstrate that he had financial difficulties.

He said that because his business in Hong Kong was no good he had to start a business in Country X.

He said that paying tax is a responsibility which should be fulfilled but not paying unreasonable tax.

The representative for the Commissioner submitted that the Taxpayer had not cooperated with the Inland Revenue Department and had not provided all of the necessary information. She said that the Taxpayer had failed to provide the evidence to support the claims which he had made and did not promptly answer questions raised by the assessor.

The representative for the Commissioner submitted that the assessor had carefully considered the claims made by the Taxpayer with regard to the legacy from his mother's estate and loans from others. She said that the Taxpayer had not provided proof of these claims. However the matter was not now before the Board because this was a hearing relating to penalty tax assessments raised under section 82A of the Inland Revenue Ordinance. She further pointed out that the financial difficulties which the Taxpayer claimed were not relevant when considering the penalties and cited D71/91, IRBRD, vol 7, 1.

She went on to say that the Taxpayer had completed secondary education, had been engaged in the jewellery trade for 15 years and was still the proprietor of the business. She also drew attention to the property transactions which the Taxpayer had conducted. She submitted that the Taxpayer was not an unsophisticated person. The representative for the

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Commissioner submitted that penalties of an average of 149% of the tax undercharged were not excessive bearing in mind that the starting point for assessing penalties has been set by previous Board of Review at 100%. This case was much more serious because of the quantum of the understatement of tax, the lack of cooperation by the Taxpayer, and the fact that he was not an unsophisticated person.

In reply to the representative for the Commissioner the Taxpayer repeated his previous submission and complained that the Inland Revenue Department had taken money from his bank account. He said that he was willing to pay the original tax assessed on his profit but considered a penalty of 150% to be excessive. The Taxpayer then referred at some length to why he considered the original tax assessed on his profit to be excessive.

Having given this case careful consideration we do not consider that the penalties imposed are excessive. As the Taxpayer said to us in the course of his submission, he is not a stupid person and is a good business man. Anyone who decides to carry on business in Hong Kong must comply with the laws of Hong Kong. These laws include the Inland Revenue Ordinance.

The Inland Revenue Ordinance requires all Taxpayers to maintain true and correct accounts of their business. This the Taxpayer failed to do. From the submission which he made to us it would appear that he made little effort to fulfil his obligations under the Inland Revenue Ordinance. It is no excuse to say that the proprietor of a business delegated all his obligations under the Inland Revenue Ordinance to his staff.

It is well known that the asset betterment statement procedure is not precise. However where a taxpayer does not keep proper accounts, then he has only himself to blame. The Inland Revenue Ordinance provides that in such circumstances the asset betterment statement procedure is appropriate and should be used. It is often difficult for a Taxpayer to explain the source of his wealth. However this is part of the asset betterment statement procedure. We pointed out in the course of the hearing that our duty in this appeal is not to reopen and reconsider the asset betterment statement but is to decide upon appropriate penalties for the Taxpayer who had failed in his obligations under the Inland Revenue Ordinance.

In all of the circumstances of this case we do not consider that the penalties imposed which come to a total of 149% of the tax undercharged are excessive. Accordingly we dismiss this appeal and confirm the additional tax assessment against the Taxpayer has appealed.