

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D112/97

Penalty tax – omissions of part of salaries and also gain on exercise of share options from tax return – whether no intention to evade tax or ignorance of law amounts to a reasonable excuse – whether 21.04% penalty excessive in the circumstances – Inland Revenue Ordinance section 82A.

Panel: Robert Wei Wen Nam SC (chairman), Herman Fung Man Hei and Roger Leung Wai Man.

Date of hearing: 12 December 1997.

Date of decision: 20 February 1998.

The taxpayer did not disclose in his tax return additional sources of income of \$145,238 as salaries and also gain on the exercise of share options. The assessor raised an additional salaries tax assessment on the taxpayer showing an additional income of \$2,524,500.

Held:

(1) As to the omission in respect of the salaries, the Board did not accept that the omission was due to oversight. As to the omission in respect of the gain on the exercise of share options, the Board ruled that no intention to evade tax or ignorance of law does not amount to a reasonable excuse.

(2) The Board found that the taxpayer's attitude was cavalier. In the circumstances, the penalty of \$40,000 represents 21.04% of the amount of tax which would have been undercharged had the tax return been accepted as correct was not excessive.

Appeal dismissed.

Yip Sham Yin Har for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

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Nature of appeal

1. This is an appeal by an individual (the Taxpayer) against the additional tax assessment raised on him for the year of assessment 1993/94 in respect of omissions of income from his salaries tax return for that year.

Facts

2. In the return, the Taxpayer declared the following income:

	\$
Salary/wages from Company A	120,000
Director fee from Company B	10,000
Executive fee from Company B	<u>319,781</u>
Total income	<u>449,781</u>

3. Upon examination of the relevant employers' returns, the assessor discovered that, apart from the sources of income mentioned in paragraph 2 above, the Taxpayer had also an additional source of income of \$145,238 as salary/wages from Company C for the period of employment from 16 February 1994 to 31 March 1994.

4. On 21 November 1994, the assessor raised a salaries tax assessment on the Taxpayer for the year of assessment 1993/94 showing a total assessable income of \$595,018 (\$449,780 + \$145,238).

6. Subsequently, the assessor discovered that the Taxpayer had yet another source of income for the year of assessment 1993/94, that is, gain on the exercise of share options in respect of \$850,000 shares of Company A.

7. On 10 May 1996, the assessor raised an additional salaries tax assessment on the Taxpayer for the year of assessment 1993/94 showing an additional income of \$2,524,500.

8. On 20 May 1996, the Taxpayer lodged an objection to the additional assessment which was to the following effect:

8.1 He was not aware that he had to pay income tax on his shares option until he received the demand note.

8.2 He had some shares option granted to him from Company A in June 1993.

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8.3 The exercise date of his shares option was 17 May 1993 and the closing rate was \$2.65. The realized gain was \$1,122,000. Detailed computation was as follows...

9. On 3 December 1996, the additional assessment was revised with the total income reduced to \$1,717,018 and the additional income from gain on exercise of share option reduced to \$1,122,000.

10. On 10 February 1996, the Commissioner of Inland Revenue gave notice to the Taxpayer under section 82(4) of the Inland Revenue Ordinance (the IRO) that he proposed to assess the Taxpayer to additional tax in respect of the year of assessment 1993/94 and that the Taxpayer had the right to submit written representations to the Commissioner in respect of the proposed additional tax assessment.

11. On 15 February 1997, the Taxpayer submitted written representations to the Commissioner which were to the following effect:

11.1 Staff Share Option – Company A.

When acquiring the share option in 1991 and 1992, it was always his intention to keep it as a long-term investment.

The share option was exercised in 1993 as a result of a change in the controlling shareholder in Company A.

It was the first time that a share option was offered to him and he did not realize that there was tax payable on gain on the exercise of the option.

It was never his intention knowingly to avoid paying any taxation due.

When receiving the notice of assessment he realized the oversight and had made prompt settlement of the tax due.

11.2 Salaries tax – Company C.

Due to oversight as he was changing his job between the fiscal year 1993/94, he had not declared this amount. However, he had paid promptly as requested by the Inland Revenue Department.

12. On 9 May 1997, the Commissioner, after considering and taking into account the representations submitted by the Taxpayer, issued a notice of assessment for additional tax under section 82A of the IRO for the year of assessment 1993/94 in the amount of \$40,000.

13. On 2 June 1997, the Taxpayer gave notice of appeal to the Board against the additional tax assessment containing grounds to the same effect as in paragraph 11.1 above

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and a further statement that he had been a prompt taxpayer during his employment history in Hong Kong and that he believed in paying tax on what was due to him.

14. At the hearing of this appeal, the Taxpayer appeared on his own behalf. Apart from covering the grounds of appeal stated in his notice of appeal (see paragraphs 11.1 and 13 above), his submissions may be summarized as follows:

14.1 As an employee, he followed the particulars of the employer's return. The company did not notify him that he had to pay tax on gain made in exercise of his right to acquire shares.

14.2 He spent more than 50% of his time in Country X. He usually relied on his secretary to prepare his tax papers for him to sign. There might have been oversight on his part in following this practice.

14.3 After receiving the notice of additional assessment, he contacted the Inland Revenue Department a number of times by telephone, seeking clarification, but could not get positive feedback. So he inquired of his colleague whether he had also received something similar from the Inland Revenue Department because he had also been granted share options by the company. He eventually got assistance from his colleague.

14.4 As for income from Company C, he believed that he received the salaries in question after 31 March 1994. A change of ownership was in progress. He did not recall when he actually received the monies. But he recalled that he received the pink form after April, in fact after May 1994. As to when he got paid the salaries in question, the record said in February and March of 1994. He thought he received a cheque after that. He did not have any evidence right now.

Findings and reasons

15. **Omission in respect of gain on exercise of share options.** The Taxpayer does not deny the omission. Therefore, the first issue is whether there was a reasonable excuse for the omission. The Taxpayer put forward two main grounds: 1) that he had no intention to evade tax, and 2) that he did not know that he was required by law to report the gain. We have to say at once that neither of those grounds amounts to a reasonable excuse. While presence of an intention to evade tax is an aggravating factor, lack of such an intention is not a reasonable excuse or mitigating factor, because no honest taxpayer should have it. The Revenue are not alleging, nor are we finding, any such intention. As for the second main ground, it is settled law that ignorance of the law is no excuse. It is the duty of every citizen, including the Taxpayer, to acquaint himself with the relevant law. The Taxpayer endeavoured to show how his ignorance of the law arose: for example, he stated that he followed what was stated in the employer's return and that he relied on his secretary to prepare his tax papers for him to sign. But these are only factual explanations and not reasonable excuses.

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16. **Omission in respect of salaries from Company C.** In his representations to the Commissioner (see paragraph 11.2 above), the Taxpayer admitted the omission which he stated was due to his oversight. The notice of appeal does not contain any grounds relating to this omission. At the hearing of this appeal, the Taxpayer asserted in his submissions that he received the salaries after 31 March 1994. He put the assertion, however, not as a matter of fact, but as a matter of belief. He also made it clear that he did not have any evidence to support the assertion (see paragraph 14.4 above). That being so, we are unable to accept it.

17. **Quantum.** The next issue is whether the additional tax (penalty) is excessive. In respect of the gain on the exercise of the share options, the parties disagreed as to whether the tax return in question was sent to the Taxpayer together with the Notes which are normally sent with a tax return. The Taxpayer stated that he did not recall that he received a copy of the Notes, while Mrs Yip, the Commissioner's representative, informed us that it is the Revenue's usual practice to include a copy of the Notes when they issue a tax return. There are numerous references in the return to the Notes and to the contents thereof, and we have no doubt about the existence of the practice. On the front page, the tax return requests the Taxpayer to 'Read and follow carefully the Notes which are sent with this return'. On page 2, Part D1 states: 'Details of income chargeable to salaries tax which accrued to me during the year are as follows: [see Notes 6(a) and (b)].' Paragraph (ii) to Note 6(b) shows among other things that gains realized by the exercise of a right to acquire shares, such right being obtained by a director or employee, are income to be reported. If the Taxpayer had consulted Note 6(b), he would have realized that he should report his gain on the share options. On the other hand, assuming for argument's sake that he had not received a copy of the Notes, he should have requested the Inland Revenue Department for a copy and read the relevant Notes before completing and filing the return. There is no evidence that the Taxpayer took any steps about the Notes; all he said was that he did not recall receiving a copy of the Notes.

18. The omissions in respect of the gain on the share options and in respect of the salaries from Company C were due to a high degree of carelessness indicative of a cavalier attitude. The penalty of \$40,000 represents 21.04% of the amount of tax which would have been undercharged had the tax return been accepted as correct. In all the circumstances, we are of the view that the penalty is not excessive.

Decision

19. It follows that this appeal is dismissed and that the additional tax assessment in question is hereby confirmed.