

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D113/99

Penalty Tax – income was understated in two years of assessment – reliance placed upon this employer's return for full compliance of his obligation – absence of an intention to understate any income – whether long absence from Hong Kong is a reasonable excuse for the omission or understatement – whether penalty at the rate of 15% under section 82A of the Inland Revenue Ordinance (the 'IRO') excessive.

Panel: Anna Chow Suk Han (chairman), Edward Chow Kam Wah and William E Mocatta.

Date of hearing: 29 November 1999.

Date of decision: 27 January 2000.

The taxpayer, a company director of a company incorporated in Hong Kong in 1995, had understated his income in two years of assessment 1996/97 and 1997/98. As a result, the Revenue imposed additional tax under section 82A of the IRO against the taxpayer, who appealed to this Board against the assessment concerned. The taxpayer requested the Board to waive the imposition of additional tax as the omission on his part was not a deliberate one.

Held:

1. The taxpayer's misconception that reliance could be placed upon his employer's return for full compliance of his obligation, can neither be a ground of appeal against liability nor a mitigating factor, but it may form the basis for fixing the penalty.
2. Neither can the taxpayer's long absence from Hong Kong be a reasonable excuse for the omission or understatement nor it be a mitigating factor.
3. It was the taxpayer's claim that Hong Kong was chosen as his tax state though he spent a vast majority of time elsewhere and that he was not taking back many benefits from Hong Kong. The taxpayer must have a good reason for so doing and it was not for the Board to speculate his reason here. However, his claim did not constitute a reasonable excuse nor a mitigating factor, for the omission.
4. It has been stated many times by the Board that an intention to understate any income is an aggravating circumstance, but the absence of it, is neither a mitigating factor because every taxpayer should not have it.

INLAND REVENUE BOARD OF REVIEW DECISIONS

5. Recent cases in Hong Kong showed a consistent tariff for simple omission of income, that is, 10% of the tax undercharged.
6. Taking into account that the taxpayer was a first-time offender, the Revenue had suffered no loss, the omissions were unintentional and also the other circumstances of this case, the Board was of the view that the penalty of 15% of the tax undercharged was excessive in the circumstances of this case.
7. The Board therefore allowed the appeal to the extent that the rates of penalty of 14.81% and 15% for the respective two years of assessment concerned be each reduced to 10% and the additional tax for these two years of assessment be calculated at the reduced rate accordingly.

Appeal allowed in part.

Cases referred to:

D80/96, IRBRD, vol 11, 714

D112/97, IRBRD, vol 13, 31

Tong Cheng Yuet Kiu for the Commissioner of Inland Revenue.

Taxpayer in person.

Decision:

The appeal

1. This is an appeal by the Taxpayer against the assessments of additional tax under section 82A of the Inland Revenue Ordinance (the IRO) for the years of assessment 1996/97 and 1997/98 in the respective sums of \$26,000 and \$376,000.

The facts

2. In the tax return for individuals for the year of assessment 1995/96 on 5 May 1996 the Taxpayer declared the following income particulars:

INLAND REVENUE BOARD OF REVIEW DECISIONS

Employer	Capacity employed	Period	Amount
(blank)	(blank)	1-5-1995 to 31-3-1996	\$983,508

3. The employer's return dated 30 April 1996 filed by the Taxpayer's employer with the Inland Revenue Department revealed that the Taxpayer had the following income in the year of assessment 1995/96:

Employer	Capacity employed	Period	Particulars	Amount
Company X	Business development director	1-5-1995 to 31-3-1996	Salary	\$983,508

4. On 5 August 1996, the assessor raised the salaries tax assessment on the Taxpayer for the year of assessment 1995/96 with the following income:

Self income	<u>\$983,508</u>
-------------	------------------

5. No objection was made by the Taxpayer against this assessment.

6. In the tax return for individuals for the year of assessment 1996/97 on 11 August 1997 the Taxpayer declared the following income particulars:

Employer	Capacity employed	Period	Amount
Company X	Director	1/1996 to 1/1997	\$1,200,000

7. The employer's return dated 30 April 1997 filed by the Taxpayer's employer with the Inland Revenue Department revealed that the Taxpayer had the following income in the year of assessment 1996/97:

INLAND REVENUE BOARD OF REVIEW DECISIONS

Employer	Capacity employed	Period	Particulars	Amount \$
Company X	Business development director	1-4-1996 to 31-3-1997	Salary	1,129,550
		1-2-1995 to 31-1-1996	Commission	429,929
		1-7-1995 to 31-12-1996	15% discount on ESPP	35,291
				1,594,770

8. On 9 October 1997, the assessor raised the salaries tax assessment for the year of assessment 1996/97 on the Taxpayer with the following income:

Self income	<u>\$1,594,770</u>
-------------	--------------------

9. No objection was made by the Taxpayer against this assessment.

10. On 27 March 1998, the Commissioner of Inland Revenue gave notice to the Taxpayer under section 82A(4) of the IRO that she proposed to assess him to additional tax for the of assessment 1996/97 and invited his written representations.

11. On 11 May 1998, the assessor sent a letter to the Taxpayer requesting him to submit his written representations.

12. On 9 April 1998, Messrs Ernst & Young, the representative of Company X' wrote to the Inland Revenue Department to report the additional income of 26 employees and the additional income of the Taxpayer under Employee Stock Purchase Plan (ESPP) for years ended 31 March 1996 and 31 March 1997 of \$6,878 and \$125,259 respectively.

13. On 19 May 1998, the assessor raised an additional assessment for the year of assessment 1995/96 on the Taxpayer with additional assessable income of \$6,878.

14. On 16 June 1998, the assessor raised an additional assessment on the Taxpayer for the year of assessment 1996/97 with additional assessable income of \$125,259.

15. No objection was made by the Taxpayer against the additional assessments for the years of assessment 1995/96 and 1996/97.

INLAND REVENUE BOARD OF REVIEW DECISIONS

16. On 22 July 1998, the Commissioner gave a fresh notice to the Taxpayer under section 82A(4) of the IRO to advise him that she proposed to assess him to additional tax for the year of assessment 1996/97 and invited his written representations.

17. On 25 September 1998, the assessment sent a reminder letter to the Taxpayer requesting him to submit written representations.

18. On 3 August 1998, the Taxpayer filed the tax return for individuals for the year of assessment 1997/98 and declared the following income particulars:

Employer	Capacity employed	Period	Amount \$
Company X	Director	1-1-1997 to 31-3-1998	1,270,894
		1-1-1997 to 31-3-1998	693,819
		1-1-1997 to 31-12-1997	<u>216,957</u>
			<u><u>2,181,670</u></u>

19. The assessor, upon examination of the employer's return dated 13 May 1998, noted that the Taxpayer had the following income in the year of assessment 1997/98:

Employer	Capacity employed	Period	Particulars	Amount \$
Company X	Director of business development	1-4-1997 to 31-3-1998	Salary	1,270,894
		1-4-1997 to 31-3-1998	Commission	693,819
		1-1-1996 to 31-3-1998	Gain realized under share option scheme	19,216,306
		1-1-1997 to 31-12-1997	ESPP	216,957
				<u><u>21,397,976</u></u>

20. On 28 September 1998, the assessor raised the salaries tax assessment on the Taxpayer for the year of assessment 1997/98 with the following income:

INLAND REVENUE BOARD OF REVIEW DECISIONS

Self income \$21,397.976

21. No objection was made by the Taxpayer against this assessment.
22. Upon enquiry by the assessor on 31 August 1998 for details of share option gains of all the employees, Company X informed the Revenue on 15 September 1998 that the allowance on Employee Stock Option Exercises of \$19,216,306 reported on the employer's return for the year ended 31 March 1998 in respect of the Taxpayer should relate to two years, namely \$650,394 for the year ended 31 March 1997 and \$18,565,912 for the year ended 31 March 1998.
23. On 17 November 1998, the assessor raised another additional assessment on the Taxpayer for the year of assessment 1996/97 with additional assessable income of \$650,394.
24. On 19 November 1998, the assessor issued a notice of revised assessment to the Taxpayer for year of assessment 1997/98 with the revised assessable income of \$20,747,582 to exclude \$650,394 for the year of assessment 1996/97.
25. No objection was made against this additional assessment for year of assessment 1996/97.
26. On 3 February 1999, the Commissioner of Inland Revenue gave a fresh notice to the Taxpayer under section 82A(4) of the IRO to advise him that she proposed to assess him to additional tax for the years of assessment 1995/96, 1996/97 and 1997/98 and invited his written representations.
27. On 27 March 1999, notice of refund of salaries tax for the year of assessment 1997/98 was issued to refund 10% of the year of assessment 1997/98 final tax under section 87 of the IRO.
28. On 9 April 1999, the assessor sent a reminder letter to the Taxpayer requesting him to forward his written representations.
29. By his letter of 27 April 1999, the Taxpayer gave his representations to the Inland Revenue Department.
30. On 15 June 1999, the Commissioner issued two notices of assessment for additional tax under section 82A of the IRO for the year of assessment 1996/97 in the amount of \$26,000 and the year of assessment 1997/98 in the amount of \$376,000.
31. As a result of the understatement of income, the percentages of additional tax on the tax which would have been undercharged, are:

INLAND REVENUE BOARD OF REVIEW DECISIONS

Year of assessment	Tax which would have been undercharged	Additional tax	% of additional tax on tax which would have been undercharged
	\$	\$	
1995/96	1,031	-	-
1996/97	175,563	26,000	14.81%
1997/98	2,506,398*	376,000	15%

* Remarks: Tax undercharged after 10% tax rebate is \$2,506,398
Tax undercharged before tax rebate is \$2,784,887

32. On 13 July 1999, the taxpayer gave notice of appeal to the Board of Review against the two assessments to additional tax.

The Taxpayer's case

33. The Taxpayer appeared in person and elected not to give evidence on his own behalf. He confirmed his agreement to the facts as set out in the statement of facts prepared and submitted by the Respondent (the Revenue) together with 23 exhibits.

34. The Taxpayer's grounds of appeal are contained in his letter of representations to the Respondent of 27 April 1999 and his notice of appeal to the Board of 13 July 1999. They are summarized below.

35. The Taxpayer's employer, Company X was incorporated in Hong Kong in 1995. the Taxpayer was its director of business development in Asia Pacific. His work required him to travel extensively and for the past four years, he spent 95% of his time working outside Hong Kong.

36. Prior to his receiving a consolidated tax statement from Company X's overseas headquarters and the tax demand notes from the Revenue, he had no idea of his income gains from the Employee Stock Purchase Plan and the employee option gain.

37. It was his understanding that correct tax assessment could be made upon him by the Revenue from his employer's return. He had no intention to evade tax or to delay payment of tax.

38. He had been a good taxpayer in Hong Kong since 1982. This was the first occasion in which he was negligent in giving full particulars of his income in his tax return.

39. By virtue of his employer's returns, he paid all the taxes in full and on time.

INLAND REVENUE BOARD OF REVIEW DECISIONS

40. In his oral submission to the Board, the Taxpayer stressed the point that he was dependant on his employer to file an accurate and detailed account of his income whereupon he would pay his full tax.

41. He further submitted that while he had contributed much to Hong Kong in terms of tax payment, as he and his family were not living in Hong Kong, he had not taken back many benefits in return. Although he had other alternatives, he chose Hong Kong as his tax state.

42. He further explained that his employer had sent him copies of the employer's returns for his record, but they were sent to his Hong Kong office. When he completed his employee's returns, he was out of Hong Kong and did not have them with him as reference.

43. He also submitted that this was the first time he received option gain and these gains had not yet been realized. Ernst & Young, Company X's tax consultant, delayed in reporting the employees' option gain to the Revenue.

44. The Taxpayer requested the Board to waive the imposition of additional tax as the omission on his part was not a deliberate one.

The Respondent's (the Revenue's) case

45. In its written submission to the Board, the Respondent addressed the Board on the following points.

46. It is a taxpayer's obligation to file a true and correct tax return.

47. Every taxpayer must exercise great caution and care when filing a tax return to ensure that the return was correct. Although the employer of a taxpayer submits the taxpayer's income details to the Revenue, it is the taxpayer's duty and responsibility to declare all sources of his income in his tax return.

48. By its employer's return dated 13 May 1998, Company X reported to the Revenue the Taxpayer's share option gain of \$19,216,306. The Respondent contended that when the Taxpayer filed his employee's return of 28 July 1998, he should have already received a copy of the said return from Company X and the Taxpayer should have been able to file the correct income.

49. Apart from the share option gain, the Taxpayer also omitted his commission income and Employee Share Purchase Plan for the years of assessment 1995/96 and 1996/97. He should be aware of the fact that he had received the commission income from his employer as the amount omitted was quite substantial. Furthermore, the Taxpayer omitted to report his share option gain for the year of assessment 1997/98 in his return completed on 28 July 1998.

INLAND REVENUE BOARD OF REVIEW DECISIONS

50. The Respondent submitted that the system of taxing salaries would collapse, if an employer and an employee did not report the employee's emolument. Furthermore, the Taxpayer's agreement to the assessable income and his payment of full tax, were irrelevant to the appeal.

51. The Respondent contended that as the Taxpayer is a well educated person, his negligence in reporting his full income is not a reasonable excuse.

52. The Respondent referred us to two Board of Review decisions, namely, D80/96, IRBRD, vol 11, 714 and D112/97, IRBRD, vol 13, 31. In D80/96, 'the Board hold the view that each case should be decided on its own merits and has found that the Taxpayer was a first offender, that he was at that time ignorant of the law and that the omission was unintentional. The Board also made reference to other cases; all indicate that the rate was about 10% of the tax undercharged. The Board allowed the appeal that the additional tax under section 82A was reduced to the sums equivalent to about 10% of the tax undercharged.' In D112/97, '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.'

53. The Respondent submitted that the penalty of 15% in the present case was reasonable.

The law

54. Section 82A(1)(a) of the IRO provides that:

'Any person who without reasonable excuse makes an incorrect return by omitting or understating anything in respect of which he is required by this Ordinance to make a return, either on his behalf or on behalf of another person or a partnership, shall ... be liable to be assessed under this Section to additional tax ...'

55. Section 82B(2) 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;

INLAND REVENUE BOARD OF REVIEW DECISIONS

- (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.'*

Our findings

56. The Taxpayer's misconception that reliance could be placed upon his employer's return for full compliance of his obligation, can neither be a ground of appeal against liability nor a mitigating factor, but it may form the basis for fixing the penalty.

57. Neither can the Taxpayer's long absence from Hong Kong be a reasonable excuse for the omission or understatement nor it be a mitigating factor.

58. It is the Taxpayer's claim that Hong Kong was chosen as his tax state though he spent a vast majority of time elsewhere and that he was not taking back many benefits from Hong Kong. The Taxpayer must have a good reason for so doing and it is not for us to speculate his reason here. However, his claim does not constitute a reasonable excuse nor a mitigation factor, for the omission.

59. Since it is clear from the reasons given by the Taxpayer for his omission or understatement of his income in his tax returns that they do not constitute reasonable excuses, what left for us to determine is whether the penalty at the rate of 15% is excessive having regard to the circumstances of the case.

60. The Taxpayer submitted that he was a first-time offender, he had been a good taxpayer, the omission was not a deliberate one and the taxes were paid in full and on time.

61. It has been stated many times by the Board that an intention to understate any income is an aggravated circumstance, but the absence of it, is neither a mitigation factor because every taxpayer should not have it.

62. Recent cases in Hong Kong showed a consistent tariff for simple omission of income, is 10% of the tax undercharged.

63. The Board has carefully considered the Taxpayer's grounds of appeal, the submissions of the parties, the two Board of Review cases submitted by the Respondent and other recent Board of Review cases. Taking into account that the Taxpayer was a first-time offender, the Revenue had suffered no loss, the omissions were unintentional and also the other circumstances of this case, the Board is of the view that the penalty of 15% of the tax undercharged is excessive in the circumstances of this case. The Board therefore allows the appeal to the extent, and hereby orders, that the rates of penalty of 14.81% and 15% for the years of assessment 1996/97 and 1997/98 respectively be each reduced to 10% and the additional tax for those years of assessment be calculated at the reduced rate accordingly.

INLAND REVENUE BOARD OF REVIEW DECISIONS