Case No. D118/02

Penalty tax – appellant's failure to comply with the requirements of the notice given to him under section 51(1) of the Inland Revenue Ordinance ('IRO') – any reasonable excuse – history of additional tax – references of 100% of the tax involved as the starting point for imposition of additional tax are not intended to substitute the proper approach which is to consider whether the amount of additional tax is excessive by reference to the amount of tax undercharged – the circumstances of each particular case must be examined bearing in mind that the maximum penalty is 300% – section 82A makes no distinction between the five categories of transgressions – the exposure to treble the amount of tax undercharged is applicable to each – factors that affect the level of penalty – length and nature of the delay – unblemished record of the appellant in submitting his returns for the preceding years – the Board's comment on the penalty loading statement issued by the Revenue – an assessment at 20% of the tax involved was reasonable in the circumstances – sections 51(1), 51(8), 80(2), 82 and 82A of the IRO.

Panel: Ronny Wong Fook Hum SC (chairman), Andrew J Halkyard and Kenneth Kwok Hing Wai SC.

Date of hearing: 21 November 2002.
Date of decision: 23 January 2003.

This was an appeal against an assessment dated 9 July 2002 whereby the Commissioner levied additional tax in the sum of $59,700 against the appellant, who was a director of Companies A to D at all material times, in respect of his alleged failure to comply with the requirements of the notice given to him under section 51(1) of the IRO for the year of assessment 1996/97. The sum so levied amounts to 49.49% of $119,535, which was the tax involved in the year of assessment in question.

The facts appear sufficiently in the following judgment.

Held:

1. The Revenue's waiver of the surcharge on 27 April 1998 must have been premised in part on the non-receipt of the original notice of estimated assessment.

2. The Board was prepared to infer in the circumstances of this case that the appellant did not receive the Original Return.

3. This did not, however, dispose of the Revenue's case which was premised on the appellant's failure to comply with the notice handed to him during the interview on 19 March 1998.

4. The appellant should have submitted the First Duplicate Return within one month from 19 March 1998. He defaulted until 26 January 2002. The default was therefore over a period of three years and nine months.

5. The Revenue submitted that the default was in respect of a period of four years and eight months. That was computed on the assumption of due receipt of the Original Return. In so far as the Commissioner took the longer period into consideration in arriving at his assessment of additional tax, he would have erred in so doing.

6. The appellant sought to lay blame on the Revenue for not keeping track of his residential address as reported to the Revenue by his employer.

7. Given the Board's acceptance that his default, if any, could only have started on 19 April 1998, it was strictly unnecessary for the Board to comment on this argument.

8. The Board would confine itself to pointing out that the obligation under section 51(8) of the IRO to notify the Commissioner of the change of address is a personal obligation imposed on the appellant. He himself has to bear the consequence for non-discharge of that obligation.

9. The appellant's principal argument for non-submission of the First Duplicate Return was premised on his disagreement with the Revenue on the amount of expense reimbursement.

10. The Board accepted the submission of the Revenue that this did not constitute 'reasonable excuse'. In Alexander v Wallington General Commissioners and Inland Revenue Commissioners [1993] STC 588, the English Court of Appeal approved the following observations of Goulding J in Dunk v Havant General Commissioners [1976] STC 460:

> *' What the taxpayer has to declare is "that the return is to the best of his knowledge correct and complete". If (and I express no view, because it is not for me to go into the evidence on it, whether special difficulties arise in this particular case) a taxpayer finds circumstances that make the best of his knowledge more than usually unreliable, it is open to him to put against a figure for a particular item of income such words as "Estimated", "See accompanying memorandum", or something of that kind, and explain the*

circumstances. If he has done his best – and, of course, he is under a duty to use all proper sources of knowledge – he will not, in my view, be guilty of making a false statement providing, as I say, he puts in a genuine estimate and, if necessary, explains that it is not very reliable'.

11. The Board was of the view that a similar approach as set out in Dunk v Havant General Commissioners should have been adopted by the appellant in relation to his return for the year of assessment 1996/97.

12. There was no challenge whatsoever of the amount of income from Company A and Company D. If there were other items in dispute with the Revenue, the appellant could have explained his contention in a separate document accompanying his return. It was wholly wrong to await resolution of the dispute before submitting his return. The appellant's position was all the more untenable given his agreement on 15 June 1999 that all expenses reimbursed be subject to salaries tax for the year of assessment 1996/97.

13. The Board rejected the appellant's contention that the Revenue extended the time for his compliance by its letter of 19 December 2001. That letter outlined the terms of settlement as proposed by the Revenue in relation to the additional amount to be assessed for the years of assessment 1991/92 to 1997/98. Those terms included the submission of the Second Duplicate Return within one month from the date of that letter. The Revenue expressly reserved its right to impose additional tax after agreement on the additional amount to be assessed. There was no suggestion in that letter that the Revenue condoned the past default of the appellant.

14. For these reasons, the Board was of the view that the Appellant had no reasonable excuse for his failure to comply with the written notice given to him on 19 March 1998.

15. The Revenue adopted a 100% starting point in this case. The Board invited the Revenue to justify the same in the light of history of additional tax under section 82A; the inter-relationship between section 82A and the other penalty sections in the IRO; the decided cases of this Board and the penalty loading statement used by the Revenue in assessing additional tax.

16. Section 82A was first introduced by the Inland Revenue (Amendment) Ordinance 1969.

17. When it was first introduced, the offender was 'liable to be assessed under this section to additional tax of an amount not exceeding the amount of tax which has been undercharged in consequence of the incorrect return ...'.

18. That new section was introduced pursuant to the recommendations in Part I of the Report of the Inland Revenue Ordinance Review Committee ('the Report').

19. According to the Report, the new tax was intended to be an 'administrative penalty' not applicable to cases involving 'wilful intent to evade tax'.

20. The Report was of the further view that 'the administration should not be empowered to impose a heavier monetary penalty for an offence than the maximum penalty which the Court could impose for the same offence'. The then Commissioner of Inland Revenue envisaged that 'the full penalty equal to 100% of the tax undercharged would only be imposed for aggravated offences such as might be considered as borderline cases for prosecution under Section 82(1)'.

21. Section 82A was amended by the Inland Revenue (Amendment) (No 2) Bill published in the gazette on 27 March 1975.

22. The amendments empowered the Commissioner to impose additional tax at treble the amount of tax undercharged.

23. The amendments also brought into the net for the first time the cases where the taxpayer fails to comply with the requirements of a notice given to him under section 51(1) or (2A) or fails to comply with section 51(2).

24. The then Financial Secretary informed the Legislative Council in the course of debates on this Bill that the amendments were introduced because 'the penalties are not sufficiently high to act as a deterrent to some would-be evaders'. 'Because of high interest rates and inflation, even where the maximum penalty of 100 *per cent* is imposed as it is in the worst type of case, the taxpayer is often no worse off than if he had paid the tax in due time'. '... with a standard rate of 15 *per cent*, except for corporations where the rate is ... 16½ *per cent*, the worst that can happen to an offender if he is caught is to pay tax at 30 or 33 *per cent* – to put it at its lowest level it is worth taking a sporting chance'. The level of penalty was to serve as '... inducement to a taxpayer to make a clean breast of things and submit corrected returns'.

25. Section 82 of the IRO permits penalty to be imposed in relation to seven categories of acts committed by the offender 'wilfully with intent to evade [tax]'.

26. Section 80(2) embodies offences similar to those in section 82A but envisages the same being dealt with by proceedings in Court. On conviction the offender is liable to:

(a) a fine at level three (that is, $10,000) and

(b) a further fine of treble the amount of tax involved.

27. For the year of assessment 2000/01, the level of fine under section 80(2) was around $2,500. Of the 33 cases dealt with in Court between 1971 and 2002, the arithmetical mean of further fine imposed for violation of section 80(2) is 97.5% of the tax involved.

28. According to the penalty loading statement, the Revenue took into account various factors in deciding whether prosecution is to be instituted under section 80(2). Amongst those factors is 'the strength of evidence'. The Board would caution against the use of section 82A as a soft option where there is insufficient evidence to support the violation. The 'administrative penalty' should not be used as an expedient means to shift the evidential burden onto the taxpayer.

29. This Board had repeatedly recognized that it had no jurisdiction to interfere with the discretion of the Commissioner as to which statutory provision the Commissioner would select to deal with any transgression.

30. It was however a fair assumption to make that section 80(2) was reserved for more serious cases. The figure of 97.5% therefore represented the level adopted by the Court for those cases. This was on top of the average fine of $2,500 and the publicity and shame of a conviction.

31. This Board had in numerous cases referred to 100% of the tax involved as the starting point for imposition of additional tax. Such references were not intended to substitute the proper approach which was to consider whether the amount of additional tax was excessive by reference to the amount of tax undercharged.

32. The cases decided by this Board were not at one as to the circumstances whereby assessment at 100% was applicable.

33. One of the earliest statement in relation to assessment at 100% of the tax involved was to be found in D53/88, IRBRD, vol 4, 10. The Board there pointed out that penalty at 100% of the amount of tax undercharged was appropriate to those cases:

(a) where there has been no criminal intent and the taxpayer has totally failed in his or its obligations under the IRO or

(b) where the Commissioner has had to resort to investigations or the preparation of assets betterment statements or has otherwise had difficulty in assessing the tax or

(c) where the failure by the taxpayer to fulfill his or its obligations under the IRO has persisted for a number of years.

34. Similar sentiments were expressed by this Board in D34/88, IRBRD, vol 3, 336:

'As previous Boards have stated in cases of this nature, the starting point for assessing an appropriate penalty would appear to be approximately 100% of the tax underpaid. In effect, this means that, for completely ignoring one's tax obligations, one can assume that one is likely to have to pay about double the tax which other citizens who handle their tax affairs properly are required to pay.' (emphasis added).

35. These statements were at variance with the position adopted by the Board in D62/90, IRBRD, vol 5, 451 and D52/93, IRBRD, vol 8, 372 where the Board stated that:

'100% of the tax undercharged should be taken as the norm, that is, the measure for a case where there are neither aggravating nor mitigating circumstances'.

36. This statement seemed to indicate that 100% of the tax undercharged was intended to apply to the run of the mill type of cases. It was inconsistent with the broad categories outlined in D53/99 and D34/88. The Board preferred the statements in D53/88 and D34/88.

37. Given the fact that 97.5% represented the level of additional fine imposed by the Court for more serious cases, it would be wrong for the Board to adopt 100% as the starting point for a case with no aggravating or mitigating circumstances.

38. The circumstances of each particular case must be examined bearing in mind that the maximum penalty was 300%.

39. Depending on the circumstances of each individual case, the Board has approved additional tax at 200% of the tax involved in D22/90, IRBRD, vol 5, 167 and in D53/92, IRBRD, vol 7, 446 and at 210% of the tax involved plus 7% compound interest per annum in D43/01, IRBRD, vol 16, 391.

40. Section 82A made no distinction between the five categories of transgressions. The exposure to treble the amount of tax undercharged was applicable to each.

41. The Board was of the view that the principles established in D53/88 and D34/88 were equally applicable to late return cases.

42. However, as most of the late return cases did not fall into the categories established by D53/88 and D34/88, the level of penalty for those cases was much lower.

43. In D53/93, IRBRD, vol 8, 383, the Board pointed out that

> *'... a substantially lower penalty was appropriate if the delay or default related to one year of assessment only and if the return was accepted by the Revenue without requiring an investigation'.*

44. The approach of this Board was to consider the overall circumstances of each case. Factors that affect the level of penalty include:

    (a) The length and nature of the delay

    (b) The amount of tax involved

    (c) The absence of an intention to evade

    (d) Whether there is any loss of revenue

    (e) The track record of the taxpayer

    (f) The acceptance of the tax return eventually submitted without further investigation by the assessor

    (g) The lack of education on the part of the taxpayer

    (h) The steps taken to put the taxpayer's house in order

    (i) The provision of management account

    (j) Conduct of the taxpayer before this Board

45. Depending on the circumstances of each individual case, the Board had approved additional tax at 100% of the tax involved in D65/00, IRBRD, vol 15, 610 to 0.2%

of the tax involved in D24/94, IRBRD, vol 9, 226 for late submission of return without reasonable excuse.

46. The Revenue informed the Board that the penalty loading statement had been in use by the Department for almost 33 years. As pointed out by the Revenue, the table in that statement 'actually has three dimensions: one is culpability, the second is cooperation, and the third is commercial restitution'. In future, taxpayers would be advised of the category and group of penalty loading being levied in the additional tax assessments.

47. The Board welcomed the proposed publication of the penalty loading statement and the intimation that taxpayers assessed to additional tax would be informed of the basis of assessment.

48. The Board was however concerned with several aspects of the penalty loading statement placed before the Board by the Revenue:

(a) At page 3 of the penalty loading statement, the Revenue pointed out that in general, section 82A penalties were imposed by the Department on four types of cases:

(i) field audit and investigation cases;

(ii) profits tax cases;

(iii) salaries tax and property tax cases and

(iv) personal assessment cases.

(b) The Board was of the view that it was misleading to group 'field audit and investigation cases' together with the other three categories. The field audit and investigation would have been conducted in relation to cases falling within the other three categories. What should have been brought out was that field audit and investigation conducted would heighten the chance of additional tax being imposed and would have a material impact on the level of additional tax assessed.

(c) The three 'dimensions' referred to by the Revenue were certainly important factors in determining the level of additional tax. They did not constitute all the factors which this Board takes into account in deciding whether the additional tax was excessive or otherwise. The penalty loading table at page 4 of the statement also gave the misleading impression that once a case was

characterized within a 'normal loading', the assessment could only be increased up (but not down) to the maximum including commercial restitution.

(d) The Board had referred to in paragraph 50 of the decision the type of cases where a levy of 100% of the tax involved was appropriate. The penalty loading table did not fully reflect the level that the Board so indicated.

49. This was a late return case in respect of one year of assessment. The delay was three years and nine months.

50. The Board agreed with the Revenue that the appellant was reckless in relation to his obligations under the IRO. The appellant refrained from submitting any return until the Revenue had undertaken an extensive investigation. This was designed to put the onus on the Revenue to extract from him his true income as opposed to his discharging the burden of disclosure which rests squarely on every taxpayer.

51. The Board was however concerned with one tax year.

52. The Revenue said that the appellant's default for the year of assessment 1996/97 was designed to conceal his position in preceding years of assessment.

53. Given the comparatively small discrepancies in the returns of the previous years of assessment, the Board was not prepared to accept this submission.

54. Furthermore, the appellant had been penalized in respect of the other years of assessment. In respect of the year of assessment in question, he signified his agreement on 15 June 1999.

55. The notice of estimated assessment dated 24 December 1997 was premised on income at $784,840. The income after investigation was $796,900. There was loss of revenue but the loss was not substantial.

56. Apart from the year of assessment in question, the appellant had an unblemished record in submitting his returns for the preceding years of assessment.

57. Given the length and nature of the delay, the Board was of the view that this case merits additional tax at a rate higher than 10%.

58. The Board was however of the view that the Revenue had over-estimated the gravity of the delay.

59. In all the circumstances, the Board considered that an assessment at 20% of the tax involved was reasonable in the circumstances.

60. The Board allowed the appeal in part and substituted the assessment appealed against by an assessment in the sum of $23,900.

Appeal allowed in part.

Cases referred to:

D94/97, IRBRD, vol 12, 517
Alexander v Wallington General Commissioners and Inland Revenue Commissioners [1993] STC 588
Dunk v Havant General Commissioners [1976] STC 460
D53/88, IRBRD, vol 4, 10
D34/88, IRBRD, vol 3, 336
D62/90, IRBRD, vol 5, 401
D52/93, IRBRD, vol 8, 372
D22/90, IRBRD, vol 5, 167
D53/92, IRBRD, vol 7, 446
D43/01, IRBRD, vol 16, 391
D53/93, IRBRD, vol 8, 383
D2/90, IRBRD, vol 5, 77
D85/01, IRBRD, vol 16, 696
D59/96, IRBRD, vol 12, 8
D63/96, IRBRD, vol 11, 641
D65/00, IRBRD, vol 15, 610
D58/87, IRBRD, vol 3, 11
D64/94, IRBRD, vol 9, 361
D24/94, IRBRD, vol 9, 226

Chiu Kwok Kit for the Commissioner of Inland Revenue.
Chiu Ngar Wing of Messrs T C Ng & Co for the taxpayer.

Decision:

1. This is an appeal against an assessment dated 9 July 2002 whereby the Commissioner levied additional tax in the sum of $59,700 against the Appellant in respect of his alleged failure to comply with the requirements of the notice given to him under section 51(1) of the IRO for the year

of assessment 1996/97. The sum so levied amounts to 49.49% of $119,535, which is the tax involved in the year of assessment in question.

Statement of facts

2. Based on the agreed amended statement of facts, the agreed statement of supplementary facts, the bundles of documents submitted to us by the parties and bearing in mind the Appellant's comments via Messrs T C Ng & Co ('the Tax Representative') dated 21 October 2002, we make the following findings of fact.

3. During the years of assessment 1991/92 to 1997/98, the Appellant was employed by the following companies:

Year of assessment	Company A	Company B	Company C	Company D
1991/92	***	***	***	
1992/93	***	***		
1993/94	***	***		
1994/95	***			***
1995/96	***			***
1996/97	***			***
1997/98	***			***

4. At all material times, the Appellant was a director of Companies A to D. He resigned his directorship with Company C on 14 May 1996.

5. Prior to 20 July 1996, Company A carried on business at Address E.

6. On divers dates, the assessor issued tax return - individuals for completion by the Appellant. Those returns were duly completed by the Appellant and submitted to the Revenue as follows:

Year of assessment	Date of issue of return	Date of receipt of return	Income returned $
1991/92	1-5-1992	21-5-1992	569,500
1992/93	3-5-1993	25-5-1993	455,300
1993/94	2-5-1994	26-8-1994	530,000
1994/95	1-5-1995	23-5-1995	434,400
1995/96	1-5-1996	10-6-1996	728,840

7. These returns were all sent to the Appellant at Address E which was referred to as the Appellant's 'Postal Address' in each of those returns. The returns also referred to the Appellant's 'Residential Address' in Housing Estate F ('Address F').

8. On 1 July 1996, Company A applied to the Post Office for redirection of its mail from Address E to Address G for the period between 20 July 1996 and 19 October 1996. This request for re-direction was extended on 7 October 1996 for an additional year.

9. On 16 April 1997, Company A and Company D sent to the Revenue the employer's returns in respect of the earnings of the Appellant for the year ended 31 March 1997. Company A gave Address F as the residential and correspondence address of the Appellant whilst Company D gave Address G for like purpose.

10. On 1 May 1997 the assessor sent a return for the year of assessment 1996/97 ('the Original Return') to the Appellant at Address E. The Appellant was asked to complete and return the same within one month.

11. The Original Return was not submitted by the Appellant to the Revenue. In the absence of such submission the Revenue issued a notice of estimated assessment against the Appellant for tax in the sum of $117,726 payable by two instalments on 4 February 1998 ($88,294) and 5 May 1998 ($29,432). This notice of estimated assessment was also sent to the Appellant at Address E.

12. In March 1998, the Revenue commenced investigation into the tax affairs of the Appellant and Companies A to D. On 3 March 1998, the Appellant appointed the Tax Representative to deal with his tax affairs.

13. On 19 March 1998, the Appellant attended an interview with the assessors in the company of the Tax Representative. According to the notes of this interview:

(a) The assessors reminded the Appellant of the obligations of taxpayers under the IRO and the penal consequences in the event of default. The Appellant indicated that he understood the explanations.

(b) The Appellant was handed a duplicate tax return for the year of assessment 1996/97 ('the First Duplicate Return').

(c) The Appellant informed the Revenue that he had correctly reported his income and no review was carried out with his tax representative.

(d) The Appellant amended his correspondence address to care of Address G.

14. On 24 March 1998, the notice of estimated assessment referred to in paragraph 11 above was re-directed to the Tax Representative for attention of the Appellant. On 20 April 1998, the Revenue imposed a surcharge on the Appellant for failure to effect due payment. By letter dated 21 April 1998, the Appellant urged the Revenue to waive this surcharge as he did not receive the Original Return, he had no knowledge of the notice of estimated assessment until the same was re-directed to the Tax Representative and that was his first delay in paying his salaries tax. After considering these representations of the Appellant, the Revenue cancelled the surcharge on 27 April 1998. The Appellant paid the two instalments demanded in the notice of estimated assessment in late March and April 1998.

15. The return for the year of assessment 1997/98 was sent to the Tax Representative for submission by the Appellant on 1 May 1998. The Appellant duly submitted the same on 13 May 1998.

16. The Revenue continued with its investigation. By letter dated 31 March 1999, the Appellant was asked to provide information and documents for the period between 1 April 1991 and 28 February 1999. The Appellant was asked whether he would agree to offer the amount of local travelling allowances and accommodation expenses reimbursed by Company C for additional salaries tax assessment for the year of assessment 1996/97. By letter dated 15 June 1999, the Tax Representative furnished the information requested and indicated agreement on the part of the Appellant for the expenses reimbursed to be subject to salaries tax for the year of assessment 1996/97.

17. By letter dated 19 December 2001, the Revenue outlined various proposals for settlement 'on the additional amount to be assessed under Salaries Tax for the years of assessment 1991/92 to 1997/98'. The Revenue proposed that the private expenses reimbursed by the Appellant's employers, in addition to the income stated in the returns of his employers for the years of assessment 1991/92 to 1997/98 should be assessed to tax.

(a) In paragraph 4 of this letter, the Revenue stated that:

> ' For the year of assessment 1996/97 ... As a duly completed tax return is not yet submitted, I attach a duplicate Tax Return – Individuals for your completion. Please submit the return within <u>One Month</u> from the date of this letter'.

The duplicate return so attached will hereinafter be referred to as 'the Second Duplicate Return'.

(b) The Revenue pointed out in paragraph 6 of this letter that:

> ' After your basic tax liabilities are agreed, your case will be submitted to the Commissioner or her Deputy for considering the penal actions under Part XIV of the Ordinance, including prosecution, Additional Tax and compound offer. If Additional Tax is to be imposed, the maximum amount of penalty could be treble the amount of the tax undercharged.'

18. On 18 January 2002, the Tax Representative collected from the Revenue another duplicate return ('the Third Duplicate Return') for the year of assessment 1996/97. This was completed by the Appellant and returned to the assessor on 28 January 2002. The Appellant reported the following income in this return:

Employer	**Capacity**	**Period covered**		**Income**
		From	To	$
Company A	Director	1-4-1996	31-3-1997	656,849
Company C	Director	1-4-1996	31-3-1997	68,050
Company D	Director	1-4-1996	31-3-1997	72,000
				796,899

19. By letter dated 28 January 2002, the Tax Representative confirmed that the Appellant agreed to be assessed on the amount reimbursed by his employers but he claimed certain deductions for the years of assessment 1995/96 to 1997/98.

20. After further correspondence between the parties, the Appellant agreed to settle his case as follows:

Year of assessment	**Assessable income before investigation**	**Assessable income after investigation**	**Income understated**	**Tax undercharged**
	$	$	$	$
1991/92	569,500	592,003	22,503	3,375
1992/93	455,300	466,300	11,000	1,650
1993/94	530,000	574,335	44,335	6,650
1994/95	466,400	500,311	33,911	5,086
1995/96	784,840	832,517	47,677	7,151
1996/97	0	796,900	796,900	119,535
1997/98	777,000	880,012	103,012	13,906
	3,583,040	4,642,379	1,059,339	157,353

21. By a notice under section 82A(4) of the IRO dated 22 May 2002, the Commissioner informed the Appellant of his intention to raise additional tax assessments on the Appellant in respect of

(a) the Appellant's filing of incorrect returns for the years of assessment 1991/92 to 1995/96 and 1997/98 and

(b) the Appellant's failure to comply with the requirement under section 51(1) of the IRO for the year of assessment 1996/97.

22. After considering representations on behalf of the Appellant dated 11 June 2002, the Commissioner issued the following additional tax assessments on 9 July 2002.

Year of assessment	**Tax undercharged**	**Additional tax under section 82A**	**Additional tax as percentage of tax undercharged**
	$	$	%
1991/92	3,375	2,500	74.1
1992/93	1,650	1,200	72.7
1993/94	6,650	4,900	73.7
1994/95	5,086	3,800	74.7
1995/96	7,151	5,300	74.1
1996/97	119,535	59,700	50.0
1997/98	13,906	10,300	74.1
	157,353	87,700	55.7

23. There is no appeal before us in respect of the assessments for the years of assessment 1991/92 to 1995/96 and 1997/98. The only appeal is against the assessment for the year of assessment 1996/97.

Case of the Appellant

24. The Appellant submits that the Commissioner has no jurisdiction to impose additional tax under section 82A(1)(d) of the IRO as the notice under section 51(1) had not been given to him. Reliance is placed on D94/97, IRBRD, vol 12, 517.

25. The Appellant contends that there was no failure to comply as the Revenue had extended the time for compliance by its letter of 19 December 2001.

26. The Appellant further submits that he has a reasonable excuse for non-compliance with the notice:

> 'As the investigation in fact started after the appellant's non-compliance, the duplicate tax return given to the appellant is not the subject in issue because no

> matter whether it was filed right at the beginning of the investigation or at the conclusion thereof, the amount of tax undercharged would still be calculated on the total income not reported (i.e. by comparing the actual income reported with "$0")'.

27. The Appellant drew our attention to the fact that after investigation by the Revenue, the understatement for the past years was 6.82% of the total income.

28. The Appellant says that the assessment is manifestly excessive 'as the Revenue's internal guideline is 10% for the first offence and 20% for the second offence'.

Case for the Respondent

29. The notice under section 51(1) was given to the Appellant personally when the First Duplicate Return was handed to him during his interview with the assessors on 19 March 1998.

30. The Appellant adopted a cavalier attitude and deliberately refrained from submitting his return for the year of assessment in question until after conclusion of the agreement with the Revenue on all the discrepancies. On the basis of Alexander v Wallington General Commissioners and Inland Revenue Commissioners [1993] STC 588, the Revenue submits that disagreement over the amount of expense reimbursement is not a reasonable excuse for not submitting the requisite return.

31. The deliberate failure to submit the return was for the improper motive of concealing the expenses reimbursed in the preceding years. The fault on the part of the Appellant 'had been reckless, if not intentional'.

32. The additional tax imposed is not excessive because 'Adopting 100% as the starting point and give one-third discount for the small quantum involved, the penalty is around 66.7%'.

Any reasonable excuse?

33. The Revenue's waiver of the surcharge on 27 April 1998 must have been premised in part on the non-receipt of the original notice of estimated assessment. We are prepared to infer in the circumstances of this case that the Appellant did not receive the Original Return. This does not, however, dispose of the Revenue's case which is premised on the Appellant's failure to comply with the notice handed to him during the interview on 19 March 1998. The Appellant should have submitted the First Duplicate Return within one month from 19 March 1998. He defaulted until 26 January 2002. The default was therefore over a period of three years and nine months. The Revenue submitted that the default was in respect of a period of four years and eight months. That was computed on the assumption of due receipt of the Original Return. In so far as the Commissioner took the longer period into consideration in arriving at his assessment of additional tax, he would have erred in so doing.

34. The Appellant sought to lay blame on the Revenue for not keeping track of his residential address as reported to the Revenue by his employer. Given our acceptance that his default, if any, could only have started on 19 April 1998, it is strictly unnecessary for us to comment on this argument. We would confine ourselves to pointing out that the obligation under section 51(8) of the IRO to notify the Commissioner of the change of address is a personal obligation imposed on the Appellant. He himself has to bear the consequence for non-discharge of that obligation.

35. The Appellant's principal argument for non-submission of the First Duplicate Return is premised on his disagreement with the Revenue on the amount of expense reimbursement. We accept the submission of the Revenue that this does not constitute 'reasonable excuse'. In Alexander v Wallington General Commissioners and Inland Revenue Commissioners (above cited), the English Court of Appeal approved the following observations of Goulding J in Dunk v Havant General Commissioners [1976] STC 460:

> '*What the taxpayer has to declare is "that the return is to the best of his knowledge correct and complete". If (and I express no view, because it is not for me to go into the evidence on it, whether special difficulties arise in this particular case) a taxpayer finds circumstances that make the best of his knowledge more than usually unreliable, it is open to him to put against a figure for a particular item of income such words as "Estimated", "See accompanying memorandum", or something of that kind, and explain the circumstances. If he has done his best – and, of course, he is under a duty to use all proper sources of knowledge – he will not, in my view, be guilty of making a false statement providing, as I say, he puts in a genuine estimate and, if necessary, explains that it is not very reliable'.*

36. We are of the view that a similar approach should have been adopted by the Appellant in relation to his return for the year of assessment 1996/97. There was no challenge whatsoever of the amount of income from Company A and Company D. If there were other items in dispute with the Revenue, the Appellant could have explained his contention in a separate document accompanying his return. It is wholly wrong to await resolution of the dispute before submitting his return. The Appellant's position is all the more untenable given his agreement on 15 June 1999 that all expenses reimbursed be subject to salaries tax for the year of assessment 1996/97.

37. We reject the Appellant's contention that the Revenue extended the time for his compliance by its letter of 19 December 2001. That letter outlined the terms of settlement as proposed by the Revenue in relation to the additional amount to be assessed for the years of assessment 1991/92 to 1997/98. Those terms included the submission of the Second Duplicate Return within one month from the date of that letter. The Revenue expressly reserved its right to

impose additional tax after agreement on the additional amount to be assessed. There is no suggestion in that letter that the Revenue condoned the past default of the Appellant.

38. For these reasons, we are of the view that the Appellant has no reasonable excuse for his failure to comply with the written notice given to him on 19 March 1998.

History of additional tax

39. The Revenue adopted a 100% starting point in this case. We invited the Revenue to justify the same in the light of history of additional tax under section 82A; the inter-relationship between section 82A and the other penalty sections in the IRO; the decided cases of this Board and the penalty loading statement used by the Revenue in assessing additional tax.

40. Section 82A was first introduced by the Inland Revenue (Amendment) Ordinance 1969. When it was first introduced, the offender was 'liable to be assessed under this section to additional tax of an amount not exceeding the amount of tax which has been undercharged in consequence of the incorrect return ...'. That new section was introduced pursuant to the recommendations in Part I of the Report of the Inland Revenue Ordinance Review Committee ('the Report'). According to the Report, the new tax was intended to be an 'administrative penalty' not applicable to cases involving 'wilful intent to evade tax'. The Report was of the further view that 'the administration should not be empowered to impose a heavier monetary penalty for an offence than the maximum penalty which the Court could impose for the same offence'. The then Commissioner of Inland Revenue envisaged that 'the full penalty equal to 100% of the tax undercharged would only be imposed for aggravated offences such as might be considered as borderline cases for prosecution under Section 82(1)'.

41. Section 82A was amended by the Inland Revenue (Amendment) (No 2) Bill published in the gazette on 27 March 1975. The amendments empowered the Commissioner to impose additional tax at treble the amount of tax undercharged. The amendments also brought into the net for the first time the cases where the taxpayer fails to comply with the requirements of a notice given to him under section 51(1) or (2A) or fails to comply with section 51(2). The then Financial Secretary informed the Legislative Council in the course of debates on this Bill that the amendments were introduced because 'the penalties are not sufficiently high to act as a deterrent to some would-be evaders'. 'Because of high interest rates and inflation, even where the maximum penalty of 100 *per cent* is imposed as it is in the worst type of case, the taxpayer is often no worse off than if he had paid the tax in due time'. '... with a standard rate of 15 *per cent*, except for corporations where the rate is ... 16½ *per cent*, the worst that can happen to an offender if he is caught is to pay tax at 30 or 33 *per cent* – to put it at its lowest level it is worth taking a sporting chance'. The level of penalty was to serve as '... inducement to a taxpayer to make a clean breast of things and submit corrected returns'.

Inter-relationship between section 82A and the other penalty sections

42. Section 82 of the IRO permits penalty to be imposed in relation to seven categories of acts committed by the offender 'wilfully with intent to evade [tax]'.

(a) On summary conviction, the offender is liable to:

(i) a fine at level three (that is, $10,000) and

(ii) a further fine of treble the amount of tax involved and

(iii) imprisonment for six months.

(b) On conviction on indictment, the offender is liable to:

(i) a fine at level five (that is, $50,000) and

(ii) a further fine of treble the amount of tax involved and

(iii) imprisonment for three years.

According to records maintained by the Revenue, there were 47 section 82 cases tried in the District Court throughout all the years. The average fine is 1.5 times of the amount of tax involved. The offenders were visited with other penalties as provided for by that section, including an immediate custodial sentence in ten cases.

43. Section 80(2) embodies offences similar to those in section 82A but envisages the same being dealt with by proceedings in Court. On conviction the offender is liable to:

(a) a fine at level three (that is, $10,000) and

(b) a further fine of treble the amount of tax involved.

For the year of assessment 2000/01, the level of fine under section 80(2) was around $2,500. Of the 33 cases dealt with in Court between 1971 and 2002, the arithmetical mean of further fine imposed for violation of section 80(2) is 97.5% of the tax involved.

44. According to the penalty loading statement, the Revenue took into account various factors in deciding whether prosecution is to be instituted under section 80(2). Amongst those factors is 'the strength of evidence'. We would caution against the use of section 82A as a soft option where there is insufficient evidence to support the violation. The 'administrative penalty' should not be used as an expedient means to shift the evidential burden onto the taxpayer.

45. This Board has repeatedly recognised that it has no jurisdiction to interfere with the discretion of the Commissioner as to which statutory provision the Commissioner selects to deal with any transgression. It is however a fair assumption to make that section 80(2) is reserved for more serious cases. The figure of 97.5% therefore represents the level adopted by the Court for those cases. This is on top of the average fine of $2,500 and the publicity and shame of a conviction.

The 100% starting point

46. This Board has in numerous cases referred to 100% of the tax involved as the starting point for imposition of additional tax. Such references are not intended to substitute the proper approach which is to consider whether the amount of additional tax is excessive by reference to the amount of tax undercharged.

47. The cases decided by this Board are not at one as to the circumstances whereby assessment at 100% is applicable.

48. One of the earliest statement in relation to assessment at 100% of the tax involved is to be found in D53/88, IRBRD, vol 4, 10. The Board there pointed out that penalty at 100% of the amount of tax undercharged is appropriate to those cases:

(a) where there has been no criminal intent and the taxpayer has totally failed in his or its obligations under the IRO or

(b) where the Commissioner has had to resort to investigations or the preparation of assets betterment statements or has otherwise had difficulty in assessing the tax or

(c) where the failure by the taxpayer to fulfill his or its obligations under the IRO has persisted for a number of years.

49. Similar sentiments were expressed by this Board in D34/88, IRBRD, vol 3, 336:

> *'As previous Boards have stated in cases of this nature, the starting point for assessing an appropriate penalty would appear to be approximately 100% of the tax underpaid. In effect, this means that, for completely ignoring one's tax obligations, one can assume that one is likely to have to pay about double the tax which other citizens who handle their tax affairs properly are required to pay.'* (emphasis added).

50. These statements are at variance with the position adopted by the Board in D62/90, IRBRD, vol 5, 451 and D52/93, IRBRD, vol 8, 372 where the Board stated that:

> *'100% of the tax undercharged should be taken as the norm, that is, the measure for a case where there are neither aggravating nor mitigating circumstances'.*

This statement seems to indicate that 100% of the tax undercharged is intended to apply to the run of the mill type of cases. It is inconsistent with the broad categories outlined in D53/88 and D34/88. We prefer the statements in D53/88 and D34/88. Given the fact that 97.5% represents the level of additional fine imposed by the Court for more serious cases, it would be wrong for the Board to adopt 100% as the starting point for a case with no aggravating or mitigating circumstances. The circumstances of each particular case must be examined bearing in mind that the maximum penalty is 300%. Depending on the circumstances of each individual case, the Board has approved additional tax at 200% of the tax involved in D22/90, IRBRD, vol 5, 167 and in D53/92, IRBRD, vol 7, 446 and at 210% of the tax involved plus 7% compound interest per annum in D43/01, IRBRD, vol 16, 391.

Is there a different starting point for late return cases under section 82A(1)(d)?

51. Section 82A makes no distinction between the five categories of transgressions. The exposure to treble the amount of tax undercharged is applicable to each.

52. We are of the view that the principles established in D53/88 and D34/88 are equally applicable to late return cases. However, as most of the late return cases do not fall into the categories established by D53/88 and D34/88, the level of penalty for those cases is much lower.

53. In D53/93, IRBRD, vol 8, 383, the Board pointed out that

> *'... a substantially lower penalty was appropriate if the delay or default related to one year of assessment only and if the return was accepted by the Revenue without requiring an investigation'.*

54. The approach of this Board is to consider the overall circumstances of each case. Factors that affect the level of penalty include:

(a) The length and nature of the delay

D2/90, IRBRD, vol 5, 77 and D85/01, IRBRD, vol 16, 696

(b) The amount of tax involved

D2/90 (above cited)

(c) The absence of an intention to evade

D53/93 (above cited)

(d) Whether there is any loss of revenue

D59/96, IRBRD, vol 12, 8, D63/96, IRBRD, vol 11, 641 and D65/00, IRBRD, vol 15, 610

(e) The track record of the taxpayer

D59/96 (above cited) and D63/96 (above cited).

(f) The acceptance of the tax return eventually submitted without further investigation by the assessor

D53/88 (above cited)

(g) The lack of education on the part of the taxpayer

D58/87, IRBRD, vol 3, 11

(h) The steps taken to put the taxpayer's house in order

D53/93 (above cited) contrasted with D65/00 (above cited)

(i) The provision of management account

D64/94, IRBRD, vol 9, 361

(j) Conduct of the taxpayer before this Board

D59/96 (above cited)

55. Depending on the circumstances of each individual case, the Board has approved additional tax at 100% of the tax involved in D65/00 to 0.2% of the tax involved in D24/94, IRBRD, vol 9, 226 for late submission of return without reasonable excuse.

The penalty loading statement

56. Mr Chiu for the Revenue informed us that the penalty loading statement has been in use by the Inland Revenue Department ('IRD') for almost 33 years. He pointed out that the table

in that statement 'actually has three dimensions: one is culpability, the second is cooperation, and the third is commercial restitution'. In his written skeleton argument before this Board, Mr Chiu indicated that in future, taxpayers will be advised of the category and group of penalty loading being levied in the additional tax assessments.

57. We welcome the proposed publication of the penalty loading statement and the intimation that taxpayers assessed to additional tax will be informed of the basis of assessment. We are however concerned with several aspects of the penalty loading statement placed before us by the Revenue:

(a) At page 3 of the penalty loading statement, the Revenue pointed out that in general, section 82A penalties are imposed by the IRD on four types of cases:

(i) field audit and investigation cases;

(ii) profits tax cases;

(iii) salaries tax and property tax cases and

(iv) personal assessment cases.

We are of the view that it is misleading to group 'field audit and investigation cases' together with the other three categories. The field audit and investigation would have been conducted in relation to cases falling within the other three categories. What should have been brought out is that field audit and investigation conducted would heighten the chance of additional tax being imposed and would have a material impact on the level of additional tax assessed.

(b) The three 'dimensions' referred to by Mr Chiu are certainly important factors in determining the level of additional tax. They do not constitute all the factors which this Board takes into account in deciding whether the additional tax is excessive or otherwise. The penalty loading table at page 4 of the statement also gives the misleading impression that once a case is characterised within a 'normal loading', the assessment can only be increased up (but not down) to the maximum including commercial restitution.

(c) We have referred to in paragraph 50 above the type of cases where a levy of 100% of the tax involved is appropriate. The penalty loading table does not fully reflect the level that we so indicated.

Applying the above principles to the facts of this case

58. This is a late return case in respect of one year of assessment. The delay was three years and nine months.

59. We agree with the Revenue that the Appellant was reckless in relation to his obligations under the IRO. He refrained from submitting any return until the Revenue had undertaken an extensive investigation. This is designed to put the onus on the Revenue to extract from him his true income as opposed to his discharging the burden of disclosure which rests squarely on every taxpayer. We are however concerned with one tax year. The Revenue says that the Appellant's default for the year of assessment 1996/97 was designed to conceal his position in preceding years of assessment. Given the comparatively small discrepancies in the returns of the previous years of assessment, we are not prepared to accept this submission. Furthermore, the Appellant had been penalised in respect of the other years of assessment. In respect of the year of assessment in question, he signified his agreement on 15 June 1999.

60. The notice of estimated assessment dated 24 December 1997 was premised on income at $784,840. The income after investigation was $796,900. There was loss of revenue but the loss is not substantial.

61. Apart from the year of assessment in question, the Appellant had an unblemished record in submitting his returns for the preceding years of assessment.

62. Given the length and nature of the delay, we are of the view that this case merits additional tax at a rate higher than 10%. We are however of the view that the Revenue had over-estimated the gravity of the delay. In all the circumstances, we consider that an assessment at 20% of the tax involved is reasonable in the circumstances.

63. We allow the appeal in part and substitute the assessment appealed against by an assessment in the sum of $23,900.