

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D118/99

Penalty Tax – section 82A of the Inland Revenue Ordinance – whether no accounting experience and lack of criminal intent are factors for reduction.

Panel: Ronny Wong Fook Hum SC (chairman), Ho Kai Cheong and Dennis Law Shiu Ming.

Date of hearing: 9 December 1999.

Date of decision: 14 February 2000.

The taxpayer and his wife were and still are the only directors and shareholders of Company A. On 23 December 1998, the taxpayer agreed on behalf of Company A its understated assessable profits for the five years of assessment from 1992 to 1997. The Commissioner imposed additional tax on the taxpayer under section 82A of the Inland Revenue Ordinance. The taxpayer appealed against the additional assessments.

It was the taxpayer's case that the errors arose as a result of the misunderstanding and lack of communication between the part-time accountant of Company A and its bookkeeper. The taxpayer contended that the investigation by the Revenue was disruptive and he had been co-operative with the Revenue in their investigations. The taxpayer further adverted to the poor economic climate and the efforts made by Company A to survive.

Held:

The fact that the managing director of the taxpayer company had no accounting experience is immaterial, as was the fact that he relied on others who did not have sufficient expertise. The taxpayer's business operations were substantial. It should have hired competent staff. The starting point of assessing penalties is 10% of the tax underpaid. There were no extenuating circumstances in that case which warranted a reduction. Lack of criminal intent is not a factor for reduction, since such intent would have resulted in criminal proceedings (D34/88, IRBRD, vol 3, 336 applied).

Appeal dismissed.

Case referred to:

D34/88, IRBRD, vol 3, 336

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Lai Au Che Chun for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

Background

1. Company A is a company incorporated in Hong Kong in 1985. It carries on a fur manufacturer business. At all material times, the Taxpayer and his wife were and still are the only directors and shareholders of Company A.
2. On behalf of Company A, the Taxpayer submitted the following returns to the Revenue:

Date of return	Year of assessment	Profit returned	Loss returned
		\$	\$
15-11-1993	1992/1993	550,492	
14-1-1995	1993/1994	143,169	
27-6-1996	1994/1995	738,631	
28-1-1997	1995/1996		611,607
14-11-1997	1996/1997	1,037,457	

3. On 10 December 1997, the Revenue informed Company A that an audit on its tax return for the year of assessment 1996/97 was being conducted. The Taxpayer met the assessor on 23 December 1997. The Taxpayer was informed that in the event of any discrepancy being found in the return for the year of assessment 1996/97, the Revenue may expand its investigation to other tax years. The assessor further explained to the Taxpayer the relevant penalty provisions.
4. The assessor found the following inaccuracies in respect of the return for the year of assessment 1996/97:
 - (a) Purchase in the sum of \$1,825,706 was reported for the years of assessment 1995/96 and 1996/97.
 - (b) Purchase in the sum of \$1,186,302 was booked twice.
 - (c) Purchase in the sum of \$700,000 was in fact a personal loan.

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- (d) Purchase in the sum of \$156,000 was in fact cancelled but there was no corresponding entry to reflect this.
- (e) Stock at the end of the year amounting to \$2,374,653 was omitted.
- (f) Profit of \$37,470 arising from LC finance was omitted.

5. The Revenue widened its investigation. The Revenue inquired in particular into the inconsistencies between the margin of profit for the years of assessment 1992/93, 1994/95 and 1995/96 when compared with the margin applicable for the years of assessment 1993/94 and 1996/97. The Taxpayer was at times assisted by Messrs Leung, Wan & Co, auditors of Company A, during his numerous interviews with the Revenue.

6. On 23 December 1998, the Taxpayer agreed on behalf of Company A its assessable profits for the following 5 years of assessment:

Year of assessment	Profits already reported/assessed	Agreed assessable profits	Understated assessable profits
	\$	\$	\$
1992/93	550,492	1,005,108	454,616
1993/94	143,169	1,554,961	1,411,792
1994/95	746,749	17,142	(729,607)
1995/96	(611,607)	2,161,986	2,773,593
1996/97	1,037,457	4,942,935	3,905,478
Total	1,866,260	9,682,132	7,815,872

7. The revised tax position of Company A as a result of this agreement is as follows:

Year of assessment	Profit already reported/assessed	Assessable profit pursuant to the agreement	Profit understated/ (Overstated)	Profits tax undercharged/ (Overcharged)
	\$	\$	\$	\$
1992/93	550,492	1,005,108	454,616	79,557
1993/94	143,169	1,554,961	1,411,792	247,064
1994/95	746,749	17,142	(729,607)	(120,385)
1995/96	(611,607)	2,161,986	2,773,593	356,727
1996/97	1,037,457	4,942,935	3,905,478	745,319
Total	1,866,260	9,682,132	7,815,872	1,308,282

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The total profit understated of \$7,815,872 is 80.72% of 9,682,132 being the total amount of assessable profit computed in accordance with the agreement reached on 23 December 1998.

8. By notice dated 11 May 1999, the Commissioner informed the Taxpayer as director of Company A of her intention to assess additional tax in respect of the incorrect returns for the years of assessment 1992/93, 1993/94, 1995/96 and 1996/97. The Taxpayer was asked to submit his written representations.

9. By letter dated 9 June 1999, the Taxpayer on behalf of Company A made the following submissions:

- (a) The errors arose as a result of the misunderstanding and lack of communication between a Ms B, part-time accountant of Company A, and its auditor.
- (b) Company A is in dire financial position. Strenuous efforts are being made in order to keep its business afloat.

10. After considering those submissions, the Commissioner by notices dated 9 July 1999 imposed the following additional tax on the Taxpayer:

Year of assessment	Amount of tax undercharged	Additional tax under section 82A	% of additional tax vis-a-vis tax undercharged
	\$	\$	
1992/93	79,557	65,000	81.7%
1993/94	247,064	203,000	82.16%
1995/96	356,727	174,000	48.77% **
1996/97	745,319	458,000	61.45%

** In relation to the additional tax for the year of assessment 1995/96, the Commissioner took into account the fact that there was over-payment of tax in the sum of \$120,385 for the year of assessment 1994/95.

11. By notice dated 5 August 1999, the Taxpayer appealed against the additional assessments on the following grounds:

- (a) The errors arose as a result of lack of communication between Company A's accountant and its bookkeeper.
- (b) The investigations by the Revenue was most disruptive. He had to face 3 different teams of the Revenue in the course of the investigation.

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- (c) He again adverted to the poor economic climate and the efforts made by Company A to survive.

The hearing before us

12. The Taxpayer appeared before us. He tendered for our consideration the following:
- (a) A statement by Ms B who asserted that the understatement of profit was unintentional and arose as a result of negligence and lack of communication.
 - (b) A letter from a company outlining the current difficulties in the fur trade and their confidence in dealing with the Taxpayer.
13. The Taxpayer also gave the following explanations:
- (a) He frankly admitted the errors. He emphasised there was no intention to understate the profits of Company A.
 - (b) The errors arose as a result of the omissions on the part of Ms B.
 - (c) He had been co-operative with the Revenue in their investigations.
14. Mrs Lai on behalf of the Revenue explained that 3 teams were involved as a result of transfers of personnel within the Department. She pointed out that the Commissioner placed full weight on the cooperation of the Taxpayer. This is borne out by the fact that total amount of additional tax is only 62.99% of the tax undercharged which is well below the level of penalty sanctioned by the decisions of this Board.

Our decision

15. We derive much assistance from D34/88, IRBRD, vol 3, 336 of this Board. The Board there pointed out that:
- (a) The fact that the managing director of the taxpayer company had no accounting experience is immaterial, as was the fact that he relied on others who did not have sufficient expertise. The taxpayer's business operations were substantial. It should have hired competent staff.
 - (b) The starting point of assessing penalties is 100% of the tax underpaid. There were no extenuating circumstances in that case which warranted a reduction.

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- (c) Lack of criminal intent is not a factor for reduction, since such intent would have resulted in criminal proceedings.

The Board refused to disturb penalties equal to between 75% and 100% (average 87%) of the tax payable assessed as a result of the taxpayer company' s failure to submit any return in time.

16. In our opinion, the Revenue has given full allowance to the cooperation of the Taxpayer on behalf of Company A in the course of the investigations between December 1997 and December 1998. We can see no other relevant factor in mitigation. The level of penalties is well in line with the decisions of this Board.

17. For these reasons, we dismiss the Taxpayer' s appeal and confirm the assessment.