

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D12/01

Penalty tax – submission of incorrect tax returns without reasonable excuse – grossly understated assessable profits in tax returns for several years of assessment – penalties imposed range from 101.14% to 111.15% of the tax undercharged – section 82A of the Inland Revenue Ordinance (‘IRO’).

Panel: Ronny Wong Fook Hum SC (chairman), Man Mo Leung and David Yip Sai On.

Date of hearing: 28 November 2000.

Date of decision: 18 April 2001.

The taxpayer had understated assessable profits for four years of assessment from 1993/94 to 1997/98. The total amount of understated assessable profits was \$1,879,274 after investigation. Additional assessments for the year of assessment 1993/94 were also subsequently issued on the taxpayer, who was allowed on the basis of a set of agreed figures.

Shortly, the Commissioner further notified the taxpayer of his intention to impose additional tax due to his submission, without reasonable excuse, of incorrect returns for the years of assessment from 1993/94 to 1996/97.

The taxpayer appealed against the additional tax, which ranged from 101.14% to 111.15% of the tax undercharged, so imposed.

Held:

1. The year of assessment 1997/98 was the ‘starting point’ for all preceding years. There was no doubt that the return submitted for the year of assessment 1997/98 was incorrect.
2. The taxpayer admitted clear mistakes in relation to the figures for ‘sales’, ‘costs of sales’ and ‘year end stock’. The arguments of the taxpayer related to further adjustments of these figures on the basis of deposits paid or deals uncompleted. These arguments therefore related to the extent as opposed to the existence of error.

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3. The Board was also satisfied that in making various assurances, the assessors had explained to the taxpayer the Revenue's position. The Revenue had taken the stance that various inclusions or exclusions asserted by the taxpayer would not accord with general accounting practice. The extent of profit understated was therefore agreed pro tanto leaving it open to the taxpayer to contend before the Board that the amount of additional tax assessed on him exceeded the amount for which he was liable. At the hearing, no effort was made to explain why the taxpayer's computation should be favoured in preference to that submitted by the Revenue.
4. The Board was of the view that the penalties levied were in line with the level of additional tax as approved by this Board.

Appeal dismissed.

Yeung Ka Sing for the Commissioner of Inland Revenue.
Taxpayer represented by his representative.

Decision:

Background

1. On 1 January 1985, the Taxpayer commenced business in the name of Company A. On 1 July 1991, the Taxpayer commenced a branch business in the name of Company B dealing in motor cars.
2. The Taxpayer submitted various returns in respect of Company A in the manner set out hereunder:

Year of assessment	Basis period	Date when return submitted	Sales reported \$	Assessable profits submitted \$
1993/94	31-3-1994	10-8-1994	43,900,501	241,664
1994/95	31-3-1995	27-7-1995	40,542,773	(36,958)
1995/96	31-3-1996	13-11-1996	40,260,602	338,651
1996/97	31-3-1997	Between July and September 1997	32,600,920	355,312
1997/98	31-3-1998	25-9-1998	51,339,000	(236,062)

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3. By a letter dated 19 October 1999, the Taxpayer was informed by the assessor that the Revenue was conducting an audit on his return for the year of assessment 1997/98 and would like to discuss with him on his financial affairs. A meeting took place between Ms C and the assessor on 10 November 1999. Ms C was the common law wife of the Taxpayer. She indicated that she participated in the running of the affairs of Company A and pursuant to requests of the assessor she provided the following pieces of information:

- (a) The reported figure for sales was inflated for the year of assessment 1997/98. She explained that a former employee of the company had erroneously included various transactions in the year of assessment 1997/98. The correct figure should have been \$28,000,000 as opposed to \$51,000,000.
- (b) The expenditure items were genuinely incurred.

4. Ms C had a further meeting with the assessor on 18 February 2000. The assessor informed Ms C, on the basis of information furnished, that:

- (a) Sales was \$33,950,000.
- (b) The costs of sale was \$32,862,471 and
- (c) The year end stock in hand was \$2,915,000.

Ms C asked for an opportunity to verify these figures.

5. The Taxpayer and Ms C met the assessor again on 16 March 2000. At this meeting:

- (a) The assessor was informed that the revised figures for the year of assessment 1997/98 were:
 - (i) Sales: \$35,136,740.
 - (ii) Costs of sale: \$34,742,692.
 - (iii) Year end stock in hand: \$2,770,000
- (b) The Taxpayer and Ms C suggested that a payment of \$130,000 by way of deposit for the purchase of motor vehicles should be treated as part of the purchase for the year of assessment 1997/98. This proposal was rejected by the Revenue on the basis that the vehicles were not contracted to be delivered until the year of assessment 1998/99 and their inclusion as

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purchase for the year of assessment 1997/98 would not accord with generally accepted accounting practice. Furthermore, if the sum of \$130,000 was to be regarded as part of the purchase for the year of assessment 1997/98, corresponding adjustments would have to be made to the year end stock in hand.

- (c) The Taxpayer pointed out that he had paid a deposit exceeding \$1,000,000 in the purchase of six Mercedes Benz prior to 31 March 1997 and such deposit should be included in the accounts for the year of assessment 1996/97. The Taxpayer pointed out that relevant documents in support of such payment were misplaced in the course of his dispute with his former employee.
- (d) The Taxpayer asserted that the profits that he made from his dealings with three trailers should form part of his submission for the year of assessment 1998/99 as those transactions were only completed in April 1998. This was rejected by the assessor as the relevant contracts were signed in March 1998.
- (e) Using the ratio between the unreported profit and reported costs of sale for the year of assessment 1997/98 as the general yard-stick, the parties agreed that the assessable profits of Company B are as follows:

Year of assessment	Profits already reported/assessed \$	Agreed assessable profits \$	Understated assessable profits \$
1993/94	277,723	715,554	437,831
1994/95	(36,958)	378,621	415,579
1995/96	489,901	892,005	402,104
1996/97	355,312	680,568	325,256
1997/98	(236,062)	62,442	298,504
Total	849,916	2,729,190	1,879,274

6. On the basis of the figures so agreed, on 29 March 2000 and 20 April 2000, the Revenue issued additional assessments on the Taxpayer for the years of assessment 1993/94 to 1997/98 totalling \$243,613. At a meeting with the assessor on 2 May 2000, the Taxpayer successfully persuaded the Revenue to permit him to discharge the additional assessments totalling \$243,613 by 24 instalments.

7. By notice dated 29 May 2000, the Commissioner notified the Taxpayer of his intention to impose additional tax due to his submission, without reasonable excuse, of incorrect

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returns for the years of assessment 1993/94 to 1996/97. After considering submissions from the Taxpayer, the Commissioner imposed additional tax in the sums and for the years of assessment outlined hereunder.

Year of assessment	Understated assessable profits \$	Tax undercharged \$	Additional tax \$	Relationship between additional tax and tax undercharged
1993/94	437,831	65,675	73,000	111.15%
1994/95	415,579	56,793	62,000	109.17%
1995/96	402,104	60,315	61,000	101.14%
1996/97	325,256	60,830	58,000	104.26%

8. The Taxpayer appeals before us against the additional tax so imposed.

The relevant provisions in the IRO

9. Section 82A provides that:

‘(1) Any person who without reasonable excuse –

(a) makes an incorrect return by omitting or understating anything in respect of which he is required by this Ordinance to make a return ...

(b) ...

shall, ... be liable to be assessed under this section to additional tax of an amount not exceeding treble the amount of tax which –

(i) has been undercharged in consequence of such incorrect return, statement or information, or would have been so undercharged if the return, statement or information had been accepted as correct ...’

10. Section 82B provides that:

‘(1) Any person who has been assessed to additional tax under section 82A may, within 1 month after notice of assessment is given to him, give notice of appeal to the Board ...

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- (2) *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;*
 - (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.'*

The hearing before us

11. The Taxpayer did not appear at the hearing before us. Ms C was authorised to act on his behalf.

12. Ms C reiterated the points made on behalf of the Taxpayer during the meeting held on 16 March 2000. She emphasised that she was assured by various assessors that she could argue these matters before us. It was on the basis of those assurances that the Taxpayer accepted the figures outlined in paragraph 5(e) above. Ms C identified the relevant assessors who made these assurances. Those assessors were present at the hearing before us. No attempt was made to call those assessors to rebut Ms C's contentions. We therefore accept that those assurances were indeed given to Ms C. However, we have to consider whether those assurances were misrepresentations on the part of the Revenue and the extent whereby such assurances can be used by Ms C to resist the claim for additional tax.

13. The year of assessment 1997/98 was the 'starting point' for all preceding years. There is no doubt that the return submitted for the year of assessment 1997/98 was incorrect. The Taxpayer admitted clear mistakes in relation to the figures for 'sales', 'costs of sales' and 'year end stock'. The arguments of the Taxpayer relate to further adjustments of these figures on the basis of deposits paid or deals uncompleted. These arguments therefore relate to the extent as opposed to the existence of error. We are therefore not persuaded that the Taxpayer 'is not liable to additional tax' on the basis that his returns were correct.

14. We are also satisfied that in making the various assurances, the assessors had explained to the Taxpayer the Revenue's position. The Revenue, in our views quite properly, had taken the stance that various inclusions or exclusions asserted on behalf of the Taxpayer would not accord with general accounting practice. The extent of profit understated was therefore agreed pro tanto leaving it open to the Taxpayer to contend before us that the amount of additional tax assessed on him exceeds the amount for which he is liable. At the hearing before us, Ms C made no effort to explain why her computation should be favoured in preference to that submitted by the

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Revenue. She did not tender any book of account nor did she place before us all relevant contracts and payments thereunder to support her contentions.

15. For these reasons, we are of the view that the Taxpayer has no defence on liability. We have considered the quantum of additional tax imposed. We are of the view that the penalties levied are in line with the level of additional tax as approved by this Board.

16. For these reasons, we dismiss the Taxpayer' s appeal.