Case No. D12/08

Penalty tax – understating assessable profits in tax return – interest element – lack of intention to evade tax – whether additional tax is excessive – sections 2(1), 64(3), 68, 70, 80(2), 82(1), 82A and 82B of the Inland Revenue Ordinance ('IRO') – section 49(1)(b) of the High Court Ordinance – section 50(1)(b) of the District Court Ordinance.

Panel: Kenneth Kwok Hing Wai SC (chairman), Diana Cheung Han Chu and Yeung Eirene.

Date of hearing: 10 April 2008.
Date of decision: 30 May 2008.

The appellant appealed against assessment to additional tax under section 82A of the Ordinance for filing incorrect profits tax returns. This is a case where:

(a) there has been no criminal intent but the appellant has totally failed in its obligations to report the correct amounts of assessable profits;

(b) the Commissioner has had to resort to a tax audit and investigations which included obtaining information from banks; and

(c) the failure of the appellant to report the correct amounts of assessable profits has persisted over a 10-year period.

The grounds of appeal, inter alia, were:

(a) The opinion of the appellant was that it has complied with the Ordinance in every respect.

(b) The appellant has disclosed full information promptly.

(c) The appellant paid the additional profits tax promptly.

(d) The additional tax in this case was excessive and should be reduced to 5% or a maximum of 15%

Held:

1. The amount of the assessable profits have been agreed to under section 64(3) and by virtue of section 70, the Revised Profits Tax Assessment as agreed to shall be final and conclusive for all purposes of this Ordinance as regards the amounts of such assessable profits. What has become final and conclusive under section 70 as a matter of law cannot be retracted. Moreover, understatement of profits is a question of fact and neither the appellant's opinion nor the Representative's opinion is relevant.

2. There was actual loss in revenue. Even if all these assessments have been paid in full by their respective due dates, the correct amount of tax had still not been in full. There was no evidence on bank interest rates. Section 49(1)(b) of the High Court Ordinance, Chapter 4, and section 50(1)(b) of the District Court Ordinance, Chapter 336, provide that judgment debts carry simple interest at such rate as may be ordered by the judge, in the absence of which, at such rate as may be determined from time to time by the Chief Justice by order. The interest element to compensate the Revenue for being kept out of the monies which should have been paid as tax was well in excess of 15%. It is simply out of the question for the appellant to ask for a maximum of 15% additional tax in this case.

3. Lack of intention to evade tax is not a mitigating factor for the simple reason that no taxpayer should have the intention to evade tax.

4. The maximum amount of additional tax is treble the amount of tax undercharged or which would have been undercharged had the returns been accepted as correct. The Assessments do not exceed the maximum. The Board has considered the circumstances in this case. In the Board's decision, additional tax at 98% is not excessive.

Appeal dismissed.

Cases referred to:

D118/02, IRBRD, vol 18, 90
D16/07, IRBRD, vol 22, 454

Isoo Iwasawa of Asahi Iwasawa & Associates Management Consultants Limited for the taxpayer.
Li Siu Keung, Pak Wai Man and Chung Yan Fat for the Commissioner of Inland Revenue.

Decision:

1. This is an appeal against the following additional assessments ('the Assessments') all dated 31 December 2007 by the Commissioner of Inland Revenue, assessing the appellant to additional tax under section 82A of the Inland Revenue Ordinance, Chapter 112, ('the Ordinance') in the following sums:

Year of assessment	Additional tax	Charge no
	$	
1995/96	247,000	1-6008577-96-3
1996/97	227,000	1-6008566-97-A
1997/98	1,732,000	1-2916843-98-A
1998/99	3,140,000	1-1129472-99-8
1999/2000	3,877,000	1-1124227-00-6
2000/01	4,067,000	1-1128993-01-3
2001/02	2,892,000	1-1126587-02-6
2002/03	2,150,000	1-1128007-03-5
2003/04	2,465,000	1-1134199-04-8
2004/05	975,000	1-1142562-05-9
Total	21,772,000	

The agreed facts

2. The appellant and the respondent agreed the facts set out in a Statement of Facts, based on which we make the following findings of fact.

3. The appellant has appealed against the Assessments all dated 31 December 2007 by the Commissioner, assessing it to additional tax under section 82A of the Ordinance for filing incorrect profits tax returns for the years of assessment 1995/96 to 2004/05.

4. The appellant is a private company incorporated in Hong Kong on 2 February 1993. It changed to the present name on 4 May 1993. At the relevant times, the shareholders of the appellant were:

	Shareholding from 20-5-1993 to 18-9-1997	Shareholding since 19-9-1997
A company incorporated in Japan ('Holding Company')	90%	---
A company incorporated in the British Virgin Islands	---	90%

('BVI Company')		
The founder of the Holding Company ('Founder')	10%	10%

and the directors of the appellant included:

	Date appointed
The Founder	20-5-1993
The BVI Company	31-3-2000
A Local Director	1-4-2003

Note : The Holding Company is a private company incorporated in Japan while the Founder is its founder.

: The BVI Company is a company incorporated in the British Virgin Islands.

: The Local Director was the senior general manager of the appellant before his appointment as its director.

5. At the relevant times, the appellant was engaged in the manufacturing of radios and other electronic products under the brand name of its customer in Japan ('the Customer') and trading of electronic parts. The appellant set up a manufacturing factory in the Mainland under a contract processing agreement. The accounts of the appellant were made up to 31 March each year.

6. It had been agreed between the appellant and the Revenue that profits derived by the appellant from sales of goods manufactured by the PRC Factory were assessable to profits tax on a 50% onshore and 50% offshore basis while profits derived by it from the trading of electronic parts were fully taxable.

7. (a) On divers dates, the appellant filed profits tax returns for the years of assessment 1995/96 to 2004/05 declaring assessable profits or losses as follows:

Year of assessment	Assessable profits/(losses)	Date of return
	$	
1995/96	12,497,270 (Note)	15-11-1996
1996/97	14,132,185	9-9-1997
1997/98	12,764,748	14-8-1998
1998/99	7,884,601	22-7-1999

1999/2000	(9,244,826)	26-9-2000
2000/01	3,103,727	24-7-2001
2001/02	2,100,031	5-11-2002
2002/03	(3,550,594)	7-11-2003
2003/04	1,143,620	19-10-2004
2004/05	(145,047)	7-11-2005

Note: Subsequently, on 17-1-1997, the appellant filed revised computation revising the assessable profits to $12,285,636.

(b) The assessable profits/losses were arrived at after deducting, inter alia, the following expenses charged in the appellant's profit and loss accounts:

Year of assessment	Technical assistance fee	Service fee	Director's remuneration to the Founder	Interest paid to the BVI Company
	$	$	$	$
1995/96	-	-	-	-
1996/97	-	-	2,400,000	-
1997/98	21,689,228	-	2,400,000	298,387
1998/99	27,847,821	3,480,978	2,400,000	1,114,801
1999/2000	36,535,663	4,412,224	2,400,000	2,600,860
2000/01	31,094,181	6,196,034	2,400,000	432,215
2001/02	23,861,674	4,772,335	2,400,000	-
2002/03	27,166,631	5,433,326	2,400,000	-
2003/04	30,793,392	6,158,678	2,400,000	-
2004/05	7,080,377	3,540,188	2,400,000	-

8. Based on the profits returned per paragraph 7(a), the assessor raised on the appellant the following profits tax assessments:

Year of assessment	Assessable profits	Tax payable	Date of issue
	$	$	
1995/96	12,285,636 Note 1	4,327 Note 2	2-1-1998
1996/97	14,132,185	2,331,810	17-10-1997
1997/98	12,764,748	2,106,183 Note 3	7-9-1998
1998/99	7,884,601	1,261,536	1-9-1999

Note:

1. Per 1995/96 revised computation [Note to paragraph 7(a)].

2. Being tax charged on net assessable profits of $26,225 (i.e. assessable profits of $12,285,636 less set off of loss brought forward of $12,259,411).

3. Subsequently, on 26-3-1999, the tax was reduced to $1,895,564 to give effect to the 10% tax rebate.

There was no objection against the above assessments.

9. In its accounts filed with the 1998/99 profits tax return on 22 July 1999, the appellant disclosed, as a prior year adjustment, that the purchase cost for the year of assessment 1995/96 had been overstated by $9,301,147.

10. By letter dated 17 October 2000, the assessor asked the appellant, through the Representative, to supply details of the interest expense of $1,114,801 [paragraph 7(b)] charged in the appellant's accounts for the year of assessment 1998/99.

11. In response, the Representative, on behalf of the appellant, informed the Revenue of the following by letter dated 10 November 2000:

> 'The adjusted loss reported in the [1999/2000] Profits Tax Return could be substantially overstated as a result of discrepancies in Purchase Account. In the course of interim audit for current financial year, we discovered significant discrepancies resulting in overstatement of purchase costs. Understanding that these discrepancies might affect our client's tax liabilities in prior years, we are conducting an extensive and in-depth investigation covering transactions taking place in prior years.'

12. By letter dated 15 December 2000, the Representative, on behalf of the appellant, filed revised accounts and tax computations for the years of assessment 1997/98 to 1999/2000 showing purchases overstated and revised assessable profits or losses as follows:

Year of assessment	Purchases overstated	Revised assessable profits/(losses)
	$	$
1997/98	3,187,069	14,358,282
1998/99	10,240,280	13,004,741
1999/2000	15,513,549	(1,488,052)

The Representative informed the Revenue that the revisions were made to rectify the tax position because the appellant had overstated its purchase cost for these three years as a result of duplicated accounting entries.

13. On 16 March 2001, the assessor raised on the appellant the following additional profits tax assessments on the basis of the revisions in paragraph 12:

Year of assessment	Additional assessable profits	Tax payable
	$	$
1997/98	1,593,534*	236,640
1998/99	5,120,140*	819,222

* being 50% of the purchases overstated per paragraph 12, after taking into account the 50/50 profit apportionment per paragraph 6.

There was no objection against the above assessments.

14. The Revenue commenced a tax audit on the tax affairs of the appellant. By letter dated 17 April 2002, the assessor informed the appellant of the tax audit.

15. On 16 May 2002, the Local Director of the appellant, accompanied by the Representative, attended the initial interview with the assessors. During the interview:

(a) The assessors informed the Local Director, inter alia, about the obligations of a taxpayer under the Ordinance to file correct tax returns and provide correct information as well as the penal provisions under the Ordinance.

(b) The Local Director informed the assessors, inter alia, that:

(i) The appellant operated under the Holding Company' s instructions. The Holding Company solicited purchase orders from the Customer and negotiated the prices. The appellant received orders from the Holding Company and arranged to have the goods manufactured. The main purpose of establishing the appellant in Hong Kong was to set up the PRC Factory. The PRC Factory acted as an assembly line to put together all parts into finished goods for sale to the Customer.

(ii) The overstatement of purchases per paragraph 12 related to purchases of the appellant made through the Holding Company. The double booking of purchases occurred in that both the original set of purchase documents (prepared in Japanese) and the duplicate set of purchase documents (prepared in Chinese) were sent to the Hong Kong office at different times. As such, the accounting staff of the appellant had inadvertently posted the same purchases twice.

16. By letter dated 29 November 2002, the assessor made enquiries on the appellant's accounts for the years of assessment 1994/95 to 2000/01. The appellant was asked, inter alia, to furnish its accounting books and records and to supply details, with supporting documents and justification, for charging the technical assistance fee, the service fee and the director's remuneration.

17. By letter dated 4 December 2002, the Representative requested an extension of time to 28 February 2003 to submit the required information and documents.

18. By letter dated 10 March 2003, the Representative gave a partial reply to the assessor's enquiries and made representations in relation to, inter alia, the annual director's remuneration of $2,400,000 paid to the Founder.

19. By letter dated 2 May 2003, the Representative gave further reply to the assessor's enquiries and stated that the rest of the information asked for would be submitted by 15 June 2003.

20. Under the cover of letter dated 6 May 2003, the appellant submitted its books and records, including general ledgers and bankbooks for the years of assessment 1994/95, 1995/96 and 1999/2000, for the assessor's examination.

21. As no further reply had been received, the assessor, by letter dated 3 May 2004, urged the appellant to submit the outstanding information asked for, namely that in relation to the service fee and the technical assistance fee (collectively 'the Fees').

22. By letter dated 28 June 2004, the Representative gave a reply stating that the recipient of the Fees was the Holding Company and furnished a copy each of the Service Agreement and the Technical Assistance Agreement, both dated 31 March 1997, between the appellant and the Holding Company. In the reply, the Representative made representations in relation to the Fees.

23. During the course and for the purposes of the tax audit, the assessor conducted bank enquiries and analysis in respect of the bank accounts held by the appellant, the BVI Company and the Holding Company.

24. Upon detailed examination of the information obtained from the banks and the accounting records submitted by the appellant for the year of assessment 1999/2000, the assessor observed that:

(a) Payments of the Fees were recorded in the appellant's ledgers from time to time.

(b) According to the Service Fee Agreement and the Technical Assistance Fee Agreement, the Holding Company was the recipient of the Fees. However, both the ledgers and the bank transactions of the appellant showed that the relevant payments were made into the BVI Company' s bank accounts in Hong Kong.

(c) After receiving payments of the Fees from the appellant, the BVI Company returned the sum to the appellant in the form of an interest bearing loan granted by the BVI Company to the appellant.

(d) The appellant would then repay the loan together with interest and the next payment of the Fees to the BVI Company and after that the sum was again returned to the appellant in the form of another interest bearing loan granted by the BVI Company to the appellant.

(e) Bank transaction records of the BVI Company for the year of assessment 1999/2000, however, did not show that the BVI Company had returned the Fees to the Holding Company.

25. As for the interest paid by the appellant to the BVI Company in respect of the loan granted, the assessor was of the view that it was not deductible.

26. By letters dated 12 January 2006 and 13 January 2006, the assessor raised further enquiries on the appellant and the Holding Company respectively in relation to the Fees and the director' s remuneration paid to the Founder. In particular, the assessor asked for documentary evidence to prove the alleged provision of technical assistance and service by the Holding Company to the appellant and the alleged managerial services performed by the Founder.

27. By letter dated 7 February 2006, the Representative, on behalf of both the appellant and the Holding Company, requested an extension of time to 28 April 2006 to give a reply. Despite the extension granted, no reply had been received from either the appellant or the Holding Company.

28. On 26 June 2006, a meeting was held between the assessor and the Local Director of the appellant, accompanied by the Representative, with a view to discussing a basis of settlement for the case. During the meeting, after clarifying other issues then under enquiry, the assessor proposed to revise the assessable profits of the appellant for the years of assessment 1995/96 to 2004/05 by adding back the claimed deductions for the Fees, the director' s remuneration paid to the Founder and the interest paid to the BVI Company. The assessor also proposed making adjustments to the assessable profits in relation to the overstatement of purchase cost, which involved the years of assessment 1995/96, 1997/98 to 1999/2000 (paragraphs 9 & 12).

29. During the course of the tax audit, the assessor raised on the appellant the following additional profits tax assessments and profits tax assessments:

Year of assessment	Assessable profits	Additional assessable profits	Date of issue
	$	$	
1995/96		22,259,411	22-3-2002
1996/97		13,200,000	30-1-2003
1997/98		10,000,000	26-3-2004
1998/99		10,000,000	24-3-2005
1999/2000	25,000,000		27-3-2006
2000/01	21,000,000		12-9-2006
2001/02	18,000,000		12-9-2006
2002/03	14,000,000		12-9-2006
2003/04	21,000,000		12-9-2006
2004/05	15,000,000		12-9-2006

The appellant, through the Tax Representative, objected against the above assessments.

30. On 26 September 2006, the appellant filed its 2005/06 profits tax return together with accounts. In the Return, the appellant declared assessable profits of $36,089,925 which was arrived at after deducting, inter alia, the following expenses charged in its profits and loss accounts:

(a)	Technical assistance fee	$59,362,572
(b)	Services fee	$11,872,514
(c)	Director's remuneration paid to the Founder	$2,400,000

31. By letter dated 29 September 2006, the assessor asked the appellant to supply certain information and documents in relation to the Fees and the director's remunerations paid to the Founder for the years of assessment 1999/2000 to 2004/05. No reply had been received from the appellant.

32. By fax dated 9 October 2006, the Representative forwarded to the assessor in draft revised tax computations of the appellant for the years of assessment 1995/96 to 2004/05 ('Draft Computations') for discussion purpose. The Draft Computations were prepared on the basis that the Fees, the director's remuneration paid to the Founder and the interest paid to the BVI Company as set out in paragraph 7(b) were not claimed for deduction and with adjustments made to account for the overstatement of purchase cost for the years of assessment 1995/96, 1997/98 to 1999/2000 (paragraphs 9 & 12).

33. On 10 October 2006, a meeting was held between the assessors and the Local Director of the appellant, accompanied by the Representative. During the meeting, the assessor suggested adopting the Draft Computations, with certain adjustments, in computing the revised assessable profits of the appellant for the years of assessment 1995/96 to 2004/05 and on the same basis for the year of assessment 2005/06. The assessor also pointed out that even if the Draft Computations were adopted, it did not conclude the whole matter as the case would be submitted to the Commissioner for consideration of penal actions against the appellant under the Ordinance.

34. By letter dated 11 October 2006, the Representative submitted a formal proposal to revise the assessable profits of the appellant for the years of assessment 1995/96 to 2005/06 as follows:

Year of assessment	Revised assessable profits
	$
1995/96	16,936,210
1996/97	15,355,350
1997/98	24,728,697
1998/99	30,450,928
1999/2000	21,539,929
2000/01	23,227,991
2001/02	17,626,011
2002/03	13,958,239
2003/04	15,321,674
2004/05	6,401,546
2005/06	73,008,382

35. The Revenue accepted the proposal in paragraph 34. Accordingly, on 24 November 2006, the assessor revised the 1995/96 to 2004/05 profits tax assessments under section 64(3) of the Ordinance ('the Revised Profits Tax Assessments') and issued 2005/06 profits tax assessment to the appellant. The appellant did not object to the 2005/06 assessment. All these assessments have become final and conclusive in terms of section 70 of the Ordinance.

36. The profits understated or losses overclaimed by the appellant and the resultant tax undercharged is summarised as follows:

Year of assessment	Assessable profits / (losses) per return	Revised assessable profits	Profits understated	Losses overclaimed	Tax undercharged
	[Paragraph	[Paragraphs 34			

	7(a)]	& 35]			
	$	$	$	$	$
1995/96	12,497,270	16,936,210	4,438,940	-	732,425
1996/97	14,132,185	15,355,350	1,223,165	-	201,822
1997/98	12,764,748	24,728,697	11,963,949	-	1,776,647
1998/99	7,884,601	30,450,928	22,566,327	-	3,610,612
1999/2000	(9,244,826)	21,539,929	21,539,929	9,244,826	3,446,388
2000/01	3,103,727	23,227,991	23,227,991	-	3,716,478
2001/02	2,100,031	17,626,011	17,626,011	-	2,820,161
2002/03	(3,550,594)	13,958,239	13,958,239	3,550,594	2,233,318
2003/04	1,143,620	15,321,674	15,321,674	-	2,681,292
2004/05	(145,047)	6,401,546	6,401,546	145,047	1,120,270
	40,685,715	185,546,575	138,267,771	12,940,467	22,339,413
2005/06	36,089,925	73,008,382	43,511,546	-	7,614,520
Total	76,775,640	258,554,957	181,779,317	12,940,467	29,953,933

37. By notice dated 13 February 2007, the Commissioner informed the appellant of her intention to assess additional tax under section 82A(4) of the Ordinance in respect of its filing of incorrect tax returns for the years of assessment 1995/96 to 2005/06.

38. No prosecution under section 80(2) or 82(1) of the Ordinance has been instituted in respect of the same facts.

39. By letter dated 6 March 2007, the Representative, on behalf of the appellant, made representations to the Commissioner.

40. By letter dated 9 October 2007, the Representative, on behalf of the appellant, submitted further representations.

41. Having considered and taken into account the representations of the appellant, the Commissioner, on 31 December 2007, issued to the appellant the Assessments for the years of assessment 1995/96 to 2004/05:

Year of assessment	Tax undercharged	Additional tax under section 82A	Additional tax as percentage of tax undercharged
	$	$	
1995/96	732,425	247,000	34%
1996/97	201,822	227,000	112%
1997/98	1,776,647	1,732,000	97%
1998/99	3,610,612	3,140,000	87%
1999/2000	3,446,388	3,877,000	112%

2000/01	3,716,478	4,067,000	109%
2001/02	2,820,161	2,892,000	103%
2002/03	2,233,318	2,150,000	96%
2003/04	2,681,292	2,465,000	92%
2004/05	1,120,270	975,000	87%
Total	22,339,413	21,772,000	98%

42. After considering the representations made by the appellant and taking into account the timing of submission by the appellant of its 2005/06 profits tax return, the revised tax computation and the settlement proposal and the issuance by the assessor of the 2005/06 profits tax assessment on the basis of the proposal, the Commissioner decided not to impose additional tax on the appellant in respect of its 2005/06 profits tax return.

43. By letter dated 8 January 2008, the Representative, on behalf of the appellant, applied for payment of the additional tax of $21,772,000 by six monthly installments. The reason given by the Representative was that the cash flow of the appellant was seriously affected due to the loss and damage suffered as a result of the fire incident at the PRC Factory on 20 December 2007. On 17 January 2008, the application was approved.

44. By letter dated 18 January 2008, the appellant, through the Representative, gave notice to the Board of Review to appeal against the Assessments.

The grounds of appeal

45. The appellant' s grounds of appeal as stated in the letter dated 18 January 2008 may be summarised as follows:

(a) The opinion of the appellant is that it has complied with the Ordinance in every respect, especially when the Holding Company was of the view that the appellant must abide by Hong Kong' s rules and regulations.

(b) The appellant has disclosed full information promptly.

(c) The appellant paid the additional profits tax promptly.

(d) The appellant suffered a loss of approximately US$4.6 million as a result of a fire at the PRC Factory.

(e) The additional tax in this case is excessive and should be reduced to 5% or a maximum of 15%.

The appeal hearing

46. By letter dated 20 March 2008, Mr Pak Wai Man wrote to the Clerk to the Board of Review asserting that:

> 'Put shortly, the dispute is merely on the quantum of the additional tax imposed. There is not going to be a revisit of the profits tax assessments which have become final and conclusive under section 70 of the Inland Revenue Ordinance.'

We were baffled by Mr Pak Wai Man's assertion.

(a) The appellant's opinion as alleged in its grounds of appeal was that it had complied with the Ordinance in every respect; and

(b) The opinion of the appellant and the Representative as alleged in the Representative's letter dated 15 March 2008 was that the appellant 'has never violated the law, nor filed an "incorrect tax return" under section 82A as indicated by the assessor'.

47. At the hearing of the appeal, the appellant was represented by the Managing Director of the Representative and the respondent by Mr Li Siu Keung.

48. Neither party called any witness.

49. In his opening, the Managing Director alleged that and we quote:

> 'They have made the payment of additional tax[1] which was disallowed amounting to roughly three million[2], and it is of their opinion that was the end.'

We told him that it was not open to him to make such allegation.

(a) The Managing Director was present at the meeting referred to in paragraph 15 above and it is plain from the meeting notes countersigned by the Local Director and the Managing Director that the assessors had explained the penal provisions under the Ordinance.

(b) It is an agreed fact that at the meeting on 10 October 2006, the assessor pointed out that settling the amount of assessable profits did not conclude the matter because the case would be submitted to the Commissioner for consideration of penal actions against the appellant, see paragraph 33 above.

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[1] We took it that the Managing Director was referring to additional *profits* tax or profits tax and not additional or penalty tax.

[2] We took it that the Managing Director meant roughly *thirty* million dollars.

According to the meeting notes, the Managing Director was present at the meeting.

50. In answer to the Board's question on whether there is any information in the hearing bundles on the delay in payment of tax arising from the filing of incorrect returns, information on bank interest rates and computation of interest, Mr Li Siu Keung sought our permission to submit the relevant materials. The Managing Director objected on the ground that he had no time to check. Commercial restitution features in the Commissioner's penal policy. Interest has been held in some Board decisions to be relevant. Information on delay and bank interest rates could, and should, have been submitted by the Revenue in this case. Mr Li Siu Keung offered no explanation why he had not done so earlier as he could and should have. In the exercise of our discretion, we refused his application. We made it clear to the Managing Director that our decision on this point did not mean we would not consider the interest element.

51. The Managing Director summed up the appellant's case as follows:

(1) The additional tax was excessive.

(2) The appellant never wilfully tried to evade tax.

(3) The overstatement of purchase cost was found out by the appellant.

(4) Some $21 million in penalty tax over close to $30 million in profits tax truly affected the cash flow of the appellant.

(5) Whether cost incurred was allowed or disallowed was a matter of opinion and in the Representative's opinion at the time, it thought those costs were allowable and the Managing Director wished to retract the statement of 'incorrect statement'.

Relevant authorities on additional tax

52. Section 68(4) of the Ordinance provides that the onus of proving that the assessment appealed against is excessive or incorrect shall lie on the appellant.

53. Section 64(3) provides that:

'(3) In the event of the Commissioner agreeing with any person assessed, who has validly objected to an assessment made upon him, as to the amount at which such person is liable to be assessed, any necessary adjustment of the assessment shall be made.'

54. Section 70, so far as relevant, provides that:

> *'Where ... the amount of the assessable ... profits ... has been agreed to under section 64(3) ... the assessment as ... agreed to ... shall be final and conclusive for all purposes of this Ordinance as regards the amount of such assessable ... profits ...*
>
> *Provided that nothing in this Part shall prevent an assessor from making an assessment or additional assessment for any year of assessment which does not involve re-opening any matter which has been determined on objection or appeal for the year.'*

55. Section 2(1) defines '*assessable profits*' as *'the profits in respect of which a person is chargeable to tax for the basis period for any year of assessment, calculated in accordance with the provisions of Part IV'.*

56. Section 82A(1) 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, either on his behalf or on behalf of another person or a partnership ...*
>
> *shall, if no prosecution under section 80(2) or 82(1) has been instituted in respect of the same facts, 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 ...'*

57. Section 82B(2) provides that:

> *'(2) On an be 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.'*

58. Section 82B(3) provides that section 68 shall, so far as applicable, have effect with respect to appeals against additional tax as if such appeals were against assessments to tax other than additional tax. The Board' s power under section 68(8)(a) includes the power to increase the assessment appealed against.

59. Section 68(9) provides that:

> *'Where under subsection (8), the Board does not reduce or annul such assessment, the Board may order the appellant to pay as costs of the Board a sum not exceeding the amount specified in Part I of Schedule 5, which shall be added to the tax charged and recovered therewith.'*

60. The amount specified in Part I of Schedule 5 is $5,000.

Incorrect returns

61. The appellant reported the following amounts of assessable profits (or losses) for the years of assessment 1995/96 to 2004/05 (see paragraph 7 above):

Year of assessment	Reported assessable profits/(losses)
	$
1995/96	12,497,270[3]
1996/97	14,132,185
1997/98	12,764,748
1998/99	7,884,601
1999/2000	(9,244,826)
2000/01	3,103,727
2001/02	2,100,031
2002/03	(3,550,594)
2003/04	1,143,620
2004/05	(145,047)

[3] Revised on 17 January 1997 to $12,285,636.

62. In the course of the tax audit, the assessor issued the assessments referred to in paragraph 29 above. The appellant objected against those assessments, see paragraph 29 above. The appellant' s objections were settled, as a result of which the assessments objected against were revised by the Revised Profits Tax Assessments as follows (see paragraphs 34 and 35 above):

Year of assessment	Revised assessable profits
	$
1995/96	16,936,210
1996/97	15,355,350
1997/98	24,728,697
1998/99	30,450,928
1999/2000	21,539,929
2000/01	23,227,991
2001/02	17,626,011
2002/03	13,958,239
2003/04	15,321,674
2004/05	6,401,546

63. Thus the amounts of the assessable profits have been agreed to under section 64(3) and by virtue of section 70, the Revised Profits Tax Assessment as agreed to shall be final and conclusive for all purposes of this Ordinance as regards the amounts of such assessable profits. Moreover, it is an agreed fact that the assessor revised the 1995/96 to 2004/05 profits tax assessments under section 64(3) of the Ordinance, see paragraph 35 above. It is not open to the appellant to dispute the correctness of the amounts of the assessable profits in the Revised Profits Tax Assessments. If the appellant has reported different amounts, its returns are incorrect and it is not open to the appellant to contend otherwise.

64. A comparison of the assessable profits (or losses) as reported by the appellant (see paragraph 61 above) and the correct amounts of assessable profits under section 70 (see paragraph 62 above) shows that the appellant has made incorrect returns for the years of assessment 1995/96 to 2004/2005 and that the appellant has understated its assessable profits and overclaimed its losses (see paragraph 36 above) as follows:

Year of assessment	Reported assessable profits/(losses)	Revised, final and conclusive assessable profits	Profits understated	Losses overclaimed
	$	$	$	$
1995/96	12,497,270[4]	16,936,210	4,438,940	
1996/97	14,132,185	15,355,350	1,223,165	
1997/98	12,764,748	24,728,697	11,963,949	
1998/99	7,884,601	30,450,928	22,566,327	

[4] Revised on 17 January 1997 to $12,285,636.

1999/2000	(9,244,826)	21,539,929	21,539,929	9,244,826
2000/01	3,103,727	23,227,991	23,227,991	
2001/02	2,100,031	17,626,011	17,626,011	
2002/03	(3,550,594)	13,958,239	13,958,239	3,550,594
2003/04	1,143,620	15,321,674	15,321,674	
2004/05	(145,047)	6,401,546	6,401,546	145,047
Total:	40,685,715	185,546,575	138,267,771	12,940,467

65. Ground (a) summarised in paragraph 45 above and contention (5) summarised in paragraph 51 above on filing of incorrect returns are plainly unarguable and have been rejected in numerous previous Board decisions. What has become final and conclusive under section 70 as a matter of law cannot be retracted. Moreover, understatement of profits is a question of fact and neither the appellant's opinion nor the Representative's opinion is relevant.

Whether liable for additional tax

66. The appellant understated its assessable profits over a 10-year period.

67. In the absence of any evidence in support, we attach no weight to any opinion attributed to the appellant or the Representative.

68. We also attach no weight to the assertion that the deductions claimed are deductible in Japan. There is simply no evidential basis for the assertion. In any event, the assertion does not sit well with the appellant's claim in ground (a) summarised in paragraph 45 above that the Holding Company was of the view that the appellant must abide by Hong Kong's rules and regulations. If that was the case, then the appellant should have approached the matter on the basis of Hong Kong's taxation regime, not Japan's alleged taxation regime.

69. In our decision, there is no, and most certainly, no reasonable, excuse for the appellant's understatement of assessable profits.

Maximum amount of additional tax

70. The maximum amount is treble the amount of tax undercharged or which would have been undercharged had the returns been accepted as correct.

71. The maximum amount of additional tax depends on the size of the tax undercharged or would have been undercharged if the returns had been accepted as correct. If the tax undercharged or would have been undercharged if the returns had been accepted as correct is large, the maximum amount is three times as large. The tax undercharged or would have been undercharged is $22,339,413. The maximum amount is $67,018,239. The Assessments do not exceed the maximum.

The 100% starting point

72. D118/02, IRBRD, vol 18, 90, is a decision of a panel chaired by the then chairman of the Board, Mr Ronny Wong Fook Hum, SC, sitting with two deputy chairmen, Professor Andrew J Halkyard and Mr Kenneth Kwok Hing Wai, SC. The Board stated that the reference to the 100% starting point in cases 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 and that the circumstances of each particular case must be examined bearing in mind that the maximum penalty is 300%, see paragraphs 46, 48 and 50:

> *'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. ...*
>
> *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*[5]
>
> *(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*[6]
>
> *(c) where the failure by the taxpayer to fulfill his or its obligations under the IRO has persisted for a number of years.*
>
> *49. …*
>
> *50. 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*

[5] Subsequent Board decisions pointed out that ' or' should read ' and'. See also D53/88 at page 13.
[6] Subsequent Board decisions pointed out that ' or' should read ' and'. See also D53/88 at page 13.

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.'

The Board's approach to omission/understatement cases

73. In D16/07 (2007-08), IRBRD, vol 22, 454 at paragraphs 125, 126 and 128, the Board (Kenneth Kwok Hing Wai SC, Eva Chan Yee Wah and Paul Lam Ting Kwok):

(1) stressed the importance of true and correct reporting by taxpayers;

(2) cited 12 recent Board cases as examples of the serious view taken by the Board of omission or understatement of income; and

(3) extracted the following propositions from those 12 cases:

(a) Receipt and accrual of income and the total amount in the 12-month period in a year of assessment are factual matters within the personal knowledge of the taxpayer. Such knowledge does not depend on the taxpayer being supplied with employer's return(s) or remembering about employer's return(s).

(b) In cases where the taxpayer was paid by autopay or deposits into the taxpayer's bank account, the taxpayer could easily have ascertained and checked the correct total amount of income by reference to the banking records.

(c) Carelessness or recklessness is not a licence to understate or omit one's income.

(d) While an intention to evade tax is undoubtedly an aggravating factor, lack of intention to evade tax is not a mitigating factor for the simple reason that no taxpayer should have the intention to evade tax, see also D62/96, IRBRD, vol 11, 633, at paragraph 23 (Robert Wei Wen Nam QC, John Peter Victor Challen and Benjamin Kwok Chi Bun).

(e) There is no duty on the part of the Revenue to warn a taxpayer before invoking section 82A.

(f) Payment of tax is not a relevant factor. It is the duty of every taxpayer to pay the correct amount of tax. If he/she does not pay tax, on time or at all, he/she will be subject to enforcement action.

(g) The fact that the Revenue was vigilant enough to detect the understatement is not a mitigating factor. The fact that the Revenue suffered no financial loss is not a mitigating factor. It is an aggravating factor if the Revenue has suffered financial loss.

(h) Financial difficulty or inability to pay the penalty must be proved by cogent evidence.

(i) In cases of an incorrect return, it is wholly unrealistic for a taxpayer to ask for zero penalty. If anything, this is an indication that the taxpayer is still not taking his/her duties seriously.

(j) There must be a real difference in penalty between those who mitigate their breaches by being co-operative and those who aggravate their breaches by being obstructive.

(k) A second or further contravention is an aggravating factor. If a taxpayer does not get the message from the Revenue' s or the Board' s treatment of the first or earlier contraventions and does not take proper steps to ensure full and complete reporting of income, a heavier penalty should, as a general rule, be imposed for subsequent contraventions.

(l) A blatant breach should be punished by a stiff penalty.

(m) In cases where the Board concludes that the additional tax assessment is excessive, the Board will reduce the penalty assessment, e.g. D9/05 and D4/06.

(n) In appropriate cases where the Board concludes that the additional tax assessment is manifestly inadequate, the Board will increase the additional tax assessment.

(o) Where the Board concludes that the appeal is frivolous and vexatious or an abuse of the process of appeal, the Board may impose an order on costs.

Whether excessive having regard to the circumstances

74. This is a case where:

(a) there has been no criminal intent but the appellant has totally failed in its obligations to report the correct amounts of assessable profits;

(b) the Commissioner has had to resort to a tax audit and investigations which included obtaining information from banks; and

(c) the failure of the appellant to report the correct amounts of assessable profits has persisted over a 10-year period.

75. There is no full or complete co-operation or full or complete disclosure by the appellant. The appellant was informed of the tax audit on about 17 April 2002. The formal proposal to settle the amounts of assessable profits was dated 11 October 2006 and the Revised Profits Tax Assessments were issued on 24 November 2006. Taking 4 ½ years to conclude a tax audit is not impressive as a mitigating factor.

76. The appellant' s conduct of this appeal also points to its half-heartedness to mitigate:

(a) The Managing Director alleged the appellant thought that the matter was concluded upon payment of the revised profits tax assessments. This allegation is contradicted by the agreed facts and the contemporaneous record of the meeting on 16 May 2002.

(b) The appellant persisted in putting forward the plainly unarguable contention that it did not file incorrect returns and went to the extent of trying to 'retract'.

77. There is actual loss in revenue. Had the appellant reported the correct amounts of assessable profits over the 10-year period, the correct amounts of tax should have been assessed by the assessor and paid by the appellant in about January of the calendar year following a year of assessment. Because of the incorrect reporting, only four assessments had been issued as per return, see paragraph 8 above. Two additional assessments had been issued as a result of the appellant volunteering information on overstatement of purchase cost, see paragraph 13 above. In the course of the tax audit, further profits tax assessments were issued (see paragraph 29 above) with the following due dates:

Year of assessment	Assessable profits	Additional assessable profits	Due dates
	$	$	
1995/96		22,259,411	2-5-2002
1996/97		13,200,000	13-3-2003
1997/98		10,000,000	7-5-2004
1998/99		10,000,000	5-5-2005
1999/2000	25,000,000		8-5-2006
2000/01	21,000,000		24-10-2006

2001/02	18,000,000	24-10-2006
2002/03	14,000,000	24-10-2006
2003/04	21,000,000	24-10-2006
2004/05	15,000,000	24-10-2006

On the basis that the correct amount of tax for the 1995/96 year of assessment should have been due in about January 1997, there is a 5-year delay for the 2 May 2002 due date. There is a delay of 4 – 5 years for the earlier years of assessment and a few months' delay for the 2004/05 year of assessment.

Even if all these assessments have been paid in full by their respective due dates, the correct amount of tax had still not been in full. The Revised Profits Tax Assessments show the following tax refunds (used to set off tax payable) or demands for payment of tax (all due on 5 January 2007):

Year of assessment	Revised assessable profits	Tax due (refunded)
	$	$
1995/96	16,936,210	(772,656)
1996/97	15,355,350	(898,178)
1997/98	24,728,697	1,540,007
1998/99	30,450,928	2,791,390
1999/2000	21,539,929	(553,612)
2000/01	23,227,991	(140,118)
2001/02	17,626,011	(59,839)
2002/03	13,958,239	(6,682)
2003/04	15,321,674	(993,708)
2004/05	6,401,546	(104,730)
	Total:	801,874

We have no evidence on bank interest rates.

Section 49(1)(b) of the High Court Ordinance, Chapter 4, and section 50(1)(b) of the District Court Ordinance, Chapter 336, provide that judgment debts carry simple interest at such rate as may be ordered by the judge, in the absence of which, at such rate as may be determined from time to time by the Chief Justice by order. The Chief Justice has ordered the rate of interest on judgment debts as follows:

% per annum	Effective date	% per annum	Effective date
9.398	1-4-2008	11.500	1-1-2000

10.420	1-1-2008	11.260	1-12-1999
10.750	1-10-2007	11.260	1-10-1999
10.750	1-7-2007	11.540	1-7-1999
10.750	1-4-2007	11.940	1-4-1999
10.934	1-1-2007	12.860	1-1-1999
11.000	1-10-2006	13.000	1-10-1998
10.921	1-7-2006	13.080	1-7-1998
10.711	1-4-2006	12.900	1-4-1998
10.088	1-1-2006	12.060	1-1-1998
9.234	1-10-2005	11.680	1-7-1997
8.245	1-7-2005	11.500	1-7-1996
8.000	1-4-2005	11.750	1-4-1996
8.069	1-1-2005	12.000	1-7-1995
8.000	1-10-2004	11.630	1-4-1995
8.000	1-7-2004	10.720	1-1-1995
8.000	1-4-2004	10.300	1-10-1994
8.000	1-1-2004	9.730	1-7-1994
8.000	1-10-2003	9.500	1-1-1993
8.000	1-7-2003	9.690	1-10-1992
8.000	1-4-2003	11.270	1-7-1992
8.093	1-1-2003	11.500	1-4-1992
8.125	1-10-2002	11.280	1-1-1992
8.125	1-7-2002	12.000	1-12-1991
8.140	1-4-2002	12.250	1-11-1991
8.720	1-1-2002	12.500	1-9-1991
9.820	1-10-2001	13.500	1-8-1991
10.860	1-7-2001	12.660	1-7-1991
12.080	1-4-2001	12.500	1-4-1991
12.500	1-1-2001	12.940	1-3-1991
12.500	1-10-2000	13.110	1-2-1991
11.980	1-7-2000	10.860	1-11-1990
11.540	1-4-2000	10.000	1-5-1990

The interest element to compensate the Revenue for being kept out of the monies which should have been paid as tax is well in excess of 15%. It is simply out of the question for the appellant to ask for a maximum of 15% additional tax in this case.

78. The best mitigating factor in this case is that the appellant volunteered information on the overstatement of purchase cost for the 1995/96, 1997/98, 1998/99 and 1999/2000 years of assessment. In this connection, it should be noted that the additional tax for the 1995/96 year of assessment (in respect of which overstatement of purchase cost appeared to be the only reason for the understatement of assessment profits) was 34%.

79. On 26 September 2006, the appellant filed its 2005/06 profits tax return declaring assessable profits of $36,089,925, having claimed deductions of $59,362,572 in technical assistance fee, $11,872,514 in service fee and $2,400,000 in director's remuneration paid to the Founder. Making these claims for deduction in the light of known and unanswered challenges and queries by the assessor does not help the appellant in this appeal. Within ½ month, the appellant offered to settle the amounts of assessable profits for the 1995/96 to 2004/05 on the footing that such items were not claimed for deduction.

80. We turn now to the grounds summarised in paragraph 45 above.

(1) We have dealt with ground (a) in paragraphs 0 and 68 above. For reasons given in paragraph 68 above, ground (a) also fails as a mitigating factor.

(2) Subject to paragraph 78 above, there is no factual basis for ground (b). For reasons given in paragraph 75 above, there is neither full nor prompt disclosure except on the overstatement of purchase cost.

(3) For reasons given in D16/07 and the cases there cited, payment of tax is not a relevant factor, see paragraph 73 above. Ground (c) fails.

(4) Financial difficulty or inability to pay the penalty must be proved by cogent evidence. The appellant applied for and was allowed to pay the additional tax by six monthly instalments. There is no evidence of financial difficulty or inability to pay any of the instalments. Ground (d) fails.

(5) For reasons given in paragraph 77 above, 15% is simply out of question. We will deal with the contention of excessiveness in paragraph 82 below.

81. It remains for us to comment on the contentions summarised in paragraph 51 above:

(1) We will deal with the contention of excessiveness in paragraph 82 below.

(2) Lack of intention to evade tax is not a mitigating factor for the simple reason that no taxpayer should have the intention to evade tax, see D16/07 and the cases there cited and paragraph 73 above. If the appellant had wilfully tried to evade tax, additional tax would have been far in excess of 100% had the Commissioner elected to assess the appellant to additional tax in place of criminal prosecution. Contention (2) fails.

(3) This is a relevant mitigating factor, see paragraph 78 above. However, this does not help the appellant in respect of the understatement of assessable profits by reason of the other claims for deductions.

(4) The tax undercharged of $29,953,933 included tax undercharged of $7,614,520 for the 2005/06 year of assessment, see paragraph 36 above. If tax undercharged of $7,614,520 for the 2005/06 year of assessment is taken into consideration, the Assessments, as a percentage of the tax undercharged will be reduced from 98% to 72.68%. More importantly, previous Board decisions have firmly established that the proper approach is to consider additional tax as a percentage of the amount of tax undercharged and decide on the appropriate percentage having regard to the circumstances of the case. The size of the additional tax depends very much on the size of the tax undercharged. Contention (4) is not the correct approach and fails.

(5) For reasons given in paragraphs 67 and 68 above, contention (5) fails as a mitigation factor.

82. We have considered the circumstances in this case. In our decision, additional tax at 98% is not excessive.

Conclusion and disposition

83. The appeal fails.

84. We dismiss the appeal and confirm the Assessments.