

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D131/01

Penalty tax – submission of incorrect tax returns without reasonable excuse – imposition of additional assessments at the average rate of 52.6% – standard practice was to use as a starting point penalty equivalent to 100% of the tax underpaid – sections 82A and 82B of the Inland Revenue Ordinance ('IRO').

Panel: Patrick Fung Pak Tung SC (chairman), Gidget Lun Kit Chi and Paul Ng Kam Yuen.

Date of hearing: 22 October 2001.

Date of decision: 8 January 2002.

The taxpayer was a car salesman employed by Company A. He received salary, bonuses and commission for car sales. At the same time, he also received commission from finance companies and other companies (Companies C, D, E, and F) for introducing clients to them for hire-purchase transactions and the taking out of insurance policies. The taxpayer was also the sole proprietor of a Company B which was carrying on the business of motors trading between 1991 and 1999.

On 26 June 2001, the Commissioner imposed additional tax on the taxpayer by way of penalty in the amount of \$91,500 under section 82A of the IRO on the ground of incorrect tax returns. On average, the percentage of additional tax assessed over undercharged tax was 52.6%. The taxpayer appealed under section 82B of the IRO against these additional or penalty tax assessments on the ground that they were excessive, albeit he had made admission that he had under-declared his assessable income or profit and signed agreement with the Inland Revenue Department ('IRD') to this effect.

In his evidence and submission, the taxpayer said that the reason why he did not report or report fully the receipt of the commission paid by the companies other than his employer was, first, that he had been advised by Company A and Company C that there was no need for him to do so and, secondly, that was the practice in the whole motor car sales trade. He further said that his practice was endorsed by the accountants he had appointed to deal with his accounts.

Held:

1. The Board was of the view that the arguments of the taxpayer did not exonerate him from his duty as a taxpayer to make correct tax returns to the IRD both regarding his

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employment and Company B.

2. The fact that the taxpayer had been wrongly advised by other people to take a certain course was not a 'reasonable excuse' within the meaning of section 82A(1) of the IRO: D179/98 IRBRD, vol 14, 78 and D71/91, IRBRD, vol 7, 1.
3. There was in fact very little room for the Board to manoeuvre after the taxpayer had made the admission that he had under-declared his assessable income or profit and signed the agreement with the IRD during negotiation.
4. It was clear from the authorities such as D52/93, IRBRD, vol 8, 372, that the standard practice was to use as a starting point penalty equivalent to 100% of the tax underpaid in cases of this nature. Here, the taxpayer had only been given an average penalty of 52.6% which was well below the normal 100%.
5. The Board had no basis or justification to say that the IRD was wrong in imposing such a penalty.

Appeal dismissed.

Cases referred to:

D179/98, IRBRD, vol 14, 78
D71/91, IRBRD, vol 7, 1
D52/93, IRBRD, vol 8, 372

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Yue Wai Kin for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

1. This is an appeal by the Appellant ('the Taxpayer') against an assessment for additional tax under section 82A of the IRO by the Respondent ('the Commissioner').
2. The additional tax assessed and demanded are contained in six notices of assessment and demand all dated 26 June 2001 and are in relation to the following years of assessment:

	\$
(a) 1993/94	6,500
(b) 1994/95	32,500
(c) 1995/96	15,000
(d) 1996/97	18,000
(e) 1997/98	18,500
(f) 1998/99	<u>1,000</u>
	<u>91,500</u>

The facts

3. The Taxpayer was a car salesman employed by Company A. The Taxpayer received from Company A a monthly salary, bonuses and commission for car sales. He also received commission from finance companies and other companies for introducing clients to them for hire-purchase transactions and the taking out of insurance policies.
4. The Taxpayer was also the sole proprietor of a business trading under the name of 'Company B' which, according to business registration records, was carrying on the business of 'Motors trading', commenced business on 28 March 1991 and ceased business on 26 March 1999.
5. Company A submitted employer's returns of remuneration and pensions in respect of the Taxpayer for the years of assessment 1993/94 to 1998/99 as follows:

Year of assessment	Date of return	Income reported
		\$
1993/94	11-5-1994	454,023
1994/95	3-5-1995	411,005

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1995/96	3-5-1996	263,398
1996/97	26-5-1997	288,085
1997/98	14-4-1998	381,029
1998/99	14-4-1999	259,562

6. Company C submitted notifications of remuneration paid to persons other than employees in respect of Company B for the years of assessment 1996/97 to 1998/99 as follows:

Year of assessment	Date of notification	Income reported
		\$
1996/97	19-5-1997	95,631
1997/98	21-5-1998	136,318
1998/99	18-5-1999	94,760

7. Company D submitted employer's returns of remuneration and pensions for the years of assessment 1993/94 and 1994/95 and notification of remuneration paid to persons other than employees for the year of assessment 1995/96 in respect of the Taxpayer as follows:

Year of assessment	Date of return/notification	Income reported
		\$
1993/94	14-5-1994	25,536
1994/95	28-4-1995	11,141
1995/96	10-5-1996	4,333

8. Company E submitted notifications of remuneration paid to persons other than employees in respect of the Taxpayer for the years of assessment 1995/96 and 1996/97 as follows:

Year of assessment	Date of notification	Income reported
		\$
1995/96	19-4-1996	6,583
1996/97	12-5-1997	2,903

9. Company F submitted employer's return of remuneration and pensions in respect of the Taxpayer for the year of assessment 1995/96 as follows:

Year of assessment	Date of notification	Income reported
		\$
1995/96	29-5-1996	1,109

10. The Taxpayer submitted tax returns – individuals for the years of assessment 1993/94 to 1998/99 as follows:

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(a) Salary income and deductions

Year of assessment	Income
	\$
1993/94	479,559
1994/95	411,005
1995/96	274,313
1996/97	290,988
1997/98	381,029
1998/99	259,562

In such tax returns, the Taxpayer claimed deduction for entertainment and other expenses but without submitting receipts in support of such claims.

(b) Income of Company B and declared profits/losses

Year of assessment	Commission receipt	Declared profits/(losses)
	\$	\$
1993/94	324,616.85	231,033
1994/95	294,565.33	90,206
1995/96	(not stated)	(4,892)
1996/97	95,631	(37,931)
1997/98	(not stated)	(69,261)
1998/99	(no profit and loss account submitted)	30,000

11. The assessor relying on the tax returns submitted by the Taxpayer made the following assessments on him:

(a) Assessment for income tax

Year of assessment	Assessable income	Expenses deducted	Income tax payable
	\$	\$	\$
1993/94	479,559	43,482	436,077
1994/95	411,005	41,100	369,905
1995/96	275,422	21,816	253,606
1996/97	290,988	22,647	268,341
1997/98	381,029	31,217	349,812
1998/99	259,562	18,975	240,587

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There was no objection or appeal by the Taxpayer against the above assessments.

(b) Assessment for profits tax

Year of assessment	Assessable profits/(assessed losses)
	\$
1993/94	231,033
1994/95	90,206
1995/96	(4,892)
1996/97	(37,931)
1997/98	(35,345)
1998/99	30,000

There was also no objection or appeal by the Taxpayer against the above assessments.

12. In 1999, the IRD made inquiries with the various finance companies concerned about commission paid to motor car sales representatives.

13. By a letter dated 30 December 1999, Company C replied and informed the IRD that it had paid commission to Company B as follows:

Year of assessment	Commission paid
	\$
1993/94	324,616.85
1994/95	323,906.81
1995/96	105,671.57

It will be noted that this information is not covered by the notifications referred to in paragraph 6 above.

14. On 8 March 2000, the assessor issued a notice of additional assessment and demand for salaries tax for the year of assessment 1993/94 and demanded additional salaries tax of \$52,500 from the Taxpayer. The Taxpayer objected to such demand.

15. Subsequently, the Taxpayer attended interviews at the IRD and there were negotiations. They culminated in an agreement signed by the Taxpayer dated 18 January 2001 whereby he agreed that his net assessable income be computed as follows:

Year of assessment	Net assessable income already reported/assessed	Agreed net assessable income	Discrepancies
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	\$	\$	\$
1993/94	436,077	728,232	292,155
1994/95	369,905	676,901	306,996
1995/96	253,606	348,711	95,105
1996/97	268,341	354,409	86,068
1997/98	349,812	472,499	122,687
1998/99	<u>240,587</u>	<u>325,871</u>	<u>85,284</u>
Total	<u>1,918,328</u>	<u>2,906,623</u>	<u>988,295</u>

The agreement also contains a declaration by the Taxpayer in the following terms:

‘ I also understand that acceptance of the abovementioned net assessable income does not conclude the whole matter and that the case will be put up to the Commissioner or Deputy Commissioner for consideration of penal actions under Part XIV of the Inland Revenue Ordinance, which include prosecution, compounding or imposition of additional tax. If additional tax is imposed, the maximum amount could be treble the amount of the tax undercharged.’

16. On 16 February 2001, the assessor issued to the Taxpayer a notice of revised assessment and demand for salaries tax for the year of assessment 1993/94 and notices of additional assessment and demand for salaries tax for the years of assessment 1994/95 to 1998/99. The calculations for ascertaining the amounts of the tax undercharged against the Taxpayer are set out below:

Year of assessment	Assessable income before revised/ additional assessment	Assessable income after revised/ additional assessment	Under-declared assessable income	Undercharged tax
	\$	\$	\$	\$
1993/94	436,077	728,232	292,155	43,823
1994/95	369,905	676,901	306,996	54,492
1995/96	253,606	348,711	95,105	19,999
1996/97	268,341	354,409	86,068	24,474
1997/98	349,812	472,499	122,687	28,340
1998/99	<u>240,587</u>	<u>325,871</u>	<u>85,284</u>	<u>2,710</u>
	<u>1,918,328</u>	<u>2,906,623</u>	<u>988,295</u>	<u>173,838</u>

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The under-declared assessable income amounted to 34% of the assessable income after the revised/additional assessment.

17. On 12 April 2001, the Commissioner issued a notice under section 82A(4) of the IRO giving notice to the Taxpayer of his intention to assess and demand additional tax under section 82A of the IRO.

18. On 5 May 2001, the Taxpayer made representation to the Commissioner objecting to the proposed assessment for additional tax.

19. On 26 June 2001, the Commissioner issued the six notices referred to in paragraph 2 above.

20. The percentage analysis of the additional tax assessed is set out below:

Year of assessment	Undercharged tax	Additional tax assessed under section 82A	Percentage of additional tax assessed over undercharged tax
	\$	\$	%
1993/94	43,823	6,500	14.8
1994/95	54,492	32,500	59.6
1995/96	19,999	15,000	75.0
1996/97	24,474	18,000	73.5
1997/98	28,340	18,500	65.3
1998/99	2,710	1,000	36.9
	<u>173,838</u>	<u>91,500</u>	<u>52.6</u>

The law

21. Section 82A(1) of the IRO provides as follows:

‘ 82A. *Additional tax in certain cases*

(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; or*

(b) *makes an incorrect statement in connection with a claim for any deduction or allowance under this Ordinance; or*

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- (c) *gives any incorrect information in relation to any matter or thing affecting his own liability to tax or the liability of any other person or of a partnership; or*
- (d) *fails to comply with the requirements of a notice given to him under section 51(1) or (2A); or*
- (e) *fails to comply with section 51(2),*

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; or*
- (ii) *has been undercharged in consequence of the failure to comply with a notice under section 51(1) or (2A) or a failure to comply with section 51(2), or which would have been undercharged if such failure had not been detected.'*

The case of the Taxpayer

22. In his evidence and submission, the Taxpayer said that the reason why he did not report or report fully the receipt of the commission paid by the companies other than his employer was, first, that he had been advised by Company A and Company C that there was no need for him to do so and, secondly, that was the practice in the whole motor car sales trade. He further said that his practice was endorsed by the accountants he had appointed to deal with his accounts.

Conclusion

23. We are of the opinion that the arguments advanced by the Taxpayer do not exonerate him from his duty as a taxpayer to make correct tax returns to the IRD both regarding his employment and Company B.

24. The fact that the Taxpayer had been wrongly advised by other people to take a certain course is not a 'reasonable excuse' within the meaning of section 82A(1) of the IRO. See, for example, Board of Review decisions D179/98, IRBRD, vol 14, 78 and D71/91, IRBRD, vol 7, 1.

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25. There is in fact very little room for the Board to manoeuvre after the Taxpayer had made the admission that he had under-declared his assessable income or profit and signed the agreement dated 18 January 2001.

26. It is clear from the authorities, for example, Board of Review decision D52/93, IRBRD, vol 8, 372, that the standard practice is to use as a starting point penalty equivalent to 100% of the tax underpaid in cases of this nature. Here, the Taxpayer has only been given an average penalty of 52.6% which is well below the normal 100%.

27. We have no basis or justification for saying that the Commissioner has been wrong in imposing such a penalty.

28. In the circumstances, we have no alternative but to dismiss the Taxpayer's appeal.