

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D143/01

**Penalty tax** – submission of incorrect tax returns without reasonable excuse – imposition of additional tax assessments at the average rate of 7% per annum compound on the amounts of tax undercharged for the delay – whether taxpayer agreed to face additional or penalty tax is irrelevant under section 82A – appeal was frivolous and vexatious and an abuse of the process – penalize in costs – sections 68(4), 68(9), 70, 82A and 82B of the Inland Revenue Ordinance ('IRO').

Panel: Kenneth Kwok Hing Wai SC (chairman), Cheung Wai Hing and Calvin Fung Chor Hang.

Date of hearing: 21 December 2001.

Date of decision: 21 January 2002.

This was an appeal against additional tax assessments in the years of assessment 1991/92 to 1994/95 under section 82A of the IRO. Additional tax assessments were indeed imposed on the appellant under section 82A(1)(a) of the IRO for making incorrect returns by understating incomes.

The facts appear sufficiently in the following judgment.

#### **Held:**

1. There are only three possible grounds of appeal under section 82B(2) of the IRO. Any ground that does not fall within these said three grounds is obviously unsustainable and the Board would reject it.
2. The onus of proving that the Assessments were excessive or incorrect was on the appellant: sections 68(4) and 82B(3) of the IRO.
3. As the appellant did not appeal against the determination made by the Commissioner in confirming the additional salaries tax assessments, by reason of section 70 of the IRO, each of the additional salaries tax assessments as determined on objection was final and conclusive for all purposes of the IRO as regards the amount of such assessable income.
4. The salaries tax returns submitted by the appellant omitted the relevant assessable incomes. They were clearly incorrect in that he had understated his incomes for the years of assessment between 1991/92 and 1994/95.

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5. The Board concluded that there was no excuse and most certainly, no reasonable excuse for the appellant to understate his incomes.
6. The Board rejected the excuses put forward by the appellant in the amended note of interview and those put forward at the hearing of the appeal.
7. Thus, the appellant was liable to be assessed to additional tax in the years of assessment 1991/92 to 1994/95 and the Assessments did not exceed the amounts for which he was liable under section 82A of the IRO.
8. Whether the appellant agreed to face additional or penalty tax was irrelevant under section 82A of the IRO. Having introduced an artificial transaction in an attempt to reduce his tax liability, he could not reasonably expect all he needed to do was to pay his salaries tax which he should have paid years ago had he reported the correct amount of employment income. He should also have known that the 'interest' charged by the Inland Revenue Department ('IRD') was interest for not paying tax by the due date(s).
9. Each case depends on its own facts. The Assessments were assessed on the basis of 7% per annum compound for the delay in assessing him on the amounts of tax undercharged.
10. This appeal was frivolous and vexatious and an abuse of the process. Pursuant to section 68(9) of the IRO, the Board ordered the appellant to pay the sum of \$5,000 as costs of the Board, which \$5,000 shall be added to the tax charged and recovered therewith.

**Appeal dismissed and a cost of 5,000 charged.**

Chan Sin Yue for the Commissioner of Inland Revenue.

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Taxpayer in person.

### Decision:

1. This is an appeal against the following additional assessments (‘ the Assessments’ ) all dated 29 August 2001 by the Commissioner of Inland Revenue, assessing the Appellant to tax under section 82A of the IRO in the following sums:

| <b>Year of assessment</b> | <b>Additional tax</b> | <b>Charge number</b> |
|---------------------------|-----------------------|----------------------|
|                           | \$                    |                      |
| 1991/92                   | 15,000                | 8-8963127-92-9       |
| 1992/93                   | 19,000                | 8-8963128-93-3       |
| 1993/94                   | 12,000                | 9-2938723-94-A       |
| 1994/95                   | 3,000                 | 9-2958132-95-5       |
| Total:                    | <u>49,000</u>         |                      |

2. The relevant provision is section 82A(1)(a) of the IRO for making incorrect returns by understating incomes.

### The facts

3. Based on the facts stated in the statement of facts which were not disputed by the Appellant, the Appellant’s salaries tax returns for the years of assessment 1987/88 and 1988/89 (paragraph 7) and the note of interview on 17 October 1997 as amended by the Appellant (paragraph 12), we make the following findings of fact.

4. At all relevant times, the Appellant and Company A were the directors and shareholders of Company B. The Appellant was a director and the majority shareholder (51%) of Company A.

5. Company B was incorporated on 21 February 1989 and ceased business on 1 August 1995. In its profits tax returns, Company B described its business as leather retail trading (1991/92), commission agency (1992/93), commission agent (1993/94) and commission agency (1994/95).

6. The Appellant signed the profits tax returns of Company B for the years of assessment 1991/92 to 1994/95. He also signed the audited accounts of Company B on behalf of Company A.

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7. In his salaries tax returns for the years of assessment 1987/88 and 1988/89, the Appellant declared that he was employed by and had derived employment income from a company called Company C.

8. The Appellant did not submit any salaries tax return for the year of assessment 1991/92. In his salaries tax return for the year of assessment 1992/93 and tax returns for individuals for the years of assessment 1993/94 and 1994/95, the Appellant provided the following details regarding his income:

| Year of assessment | Capacity in which employed | Principal office or employment | Salary/wages \$ |
|--------------------|----------------------------|--------------------------------|-----------------|
| 1992/93            | Director                   | Company B                      | 96,000          |
| 1993/94            | (blank)                    | Company B                      | 96,000          |
| 1994/95            | Operation manager          | Company D                      | 204,800         |

9. On divers dates, the assessor raised on the Appellant the following salaries tax assessments:

|                                    |  |               |
|------------------------------------|--|---------------|
| <b>Year of assessment 1991/92</b>  |  | \$            |
| Estimated assessable income        |  | 120,000       |
| Tax payable thereon                |  | 7,014         |
| <b>Year of assessment 1992/93</b>  |  | \$            |
| Assessable income                  |  | 96,000        |
| Tax payable thereon                |  | 1,006         |
| <b>Year of assessment 1993/94</b>  |  | \$            |
| Assessable income                  |  | 96,000        |
| Tax payable thereon                |  | 2,200         |
| <b>Year of assessment 1994/95</b>  |  | \$            |
| Assessable income (from Company D) |  | 204,800       |
| Assessable income (from Company E) |  | <u>26,839</u> |
| Total assessable income            |  | 231,639       |
| Tax payable thereon                |  | 24,127        |

10. No objection was lodged by the Appellant against the assessments.

11. In October 1997, the assessor commenced an investigation into the tax affairs of the Appellant.

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12. On 17 October 1997, the Appellant was interviewed by the investigation officers of the IRD. The note of interview, as amended by the Appellant, read as follows:

‘ Due to unsatisfactory result of [Company B] and financial problem the Company enter contract with [the Appellant’s brother’s] Company for extra income. According to the contract, [Company B] was entitled to a guaranteed commission. For sales of over a certain amount obtained by [Company C], [Company B] would entitle to an extra commission. Officer opined that the so-called “trade commission” was in fact employment income which should be subject to Salaries Tax. [The Appellant] mentioned that there was a contract signed between [Company B] and [the Appellant’s brother’s] Company. Officers told him that the Department would look at the substance rather than the form. [The Appellant] was not sure whether there was any money received by him on behalf of [Company B] from [Company C].’

13. The assessor did not agree that the commission income derived from Company C was profit of Company B assessable under profits tax. The assessor was of the opinion that the commission income should be assessed as the Appellant’s employment income under salaries tax.

14. On 12 February 1998, the assessor raised on the Appellant the following additional salaries tax assessments:

|  |         |
|--|---------|
| <b>Year of assessment 1991/92</b>                    | \$      |
| Additional assessable income (\$281,720 - \$120,000) | 161,720 |
| Additional tax payable thereon                       | 35,244  |
| <b>Year of assessment 1992/93</b>                    | \$      |
| Additional assessable income (\$391,500 - \$96,000)  | 295,500 |
| Additional tax payable thereon                       | 57,719  |
| <b>Year of assessment 1993/94</b>                    | \$      |
| Additional assessable income (\$360,000 - \$96,000)  | 264,000 |
| Additional tax payable thereon                       | 51,800  |
| <b>Year of assessment 1994/95</b>                    | \$      |
| Additional assessable income                         | 120,000 |
| Additional tax payable thereon                       | 24,000  |

15. By letter dated 5 March 1998, the Appellant objected to the above assessments on the ground that the additional income was not his income and should be the profit of Company B. He also submitted a completed salaries tax return to validate his objection to the additional salaries tax

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assessment for the year of assessment 1991/92, declaring income of \$120,000 having been received from Company B.

16. By his determination dated 27 April 2001, the Commissioner confirmed the additional salaries tax assessments issued on 12 February 1998.

17. On 26 June 2001, the Commissioner gave notice to the Appellant under section 82A(4) of the IRO.

18. By letter dated 29 August 2001, the Appellant made representations.

19. On 29 August 2001, the Commissioner issued the Assessments.

| <b>Year of assessment</b> | <b>Tax undercharged</b> | <b>Section 82A additional tax</b> | <b>Additional tax as percentage of tax undercharged</b> |
|---------------------------|-------------------------|-----------------------------------|---|
|                           | \$                      | \$                                | %   |
| 1991/92                   | 35,244                  | 15,000                            | 42.56   |
| 1992/93                   | 57,719                  | 19,000                            | 32.92   |
| 1993/94                   | 51,800                  | 12,000                            | 23.17   |
| 1994/95                   | <u>24,000</u>           | <u>3,000</u>                      | <u>12.50</u>  |
|                           | <u>168,763</u>          | <u>49,000</u>                     | <u>29.03</u>  |

### **The Appellant's case**

20. By an undated letter received by the Clerk to the Board of Review on 25 September 2001, the Appellant gave notice of appeal on the following grounds (the following is written exactly as it stands in the original and we shall not punctuate it with 'sic'):

1. I have provide sufficient evident to show that [Company B] is not a company to set up for tax shelter purpose.
2. I do not see the reason why [Company B] was restricted to enter a consultant agreement with another company.
3. From 1991 to 1995 I had file both personal income tax and profit tax of [Company B] and was met with approval from IRS every year.
4. I had cooperate with IRS to settle additional tax amount with interest even though I object to the additional tax.
5. I had file tax return according to law and according to factual situation.

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6. All along I had not try to cheat on tax and I do not agree that I should face additional penalty on tax on top of the additional tax that I had already settle including interest.’

21. The Appellant appeared in person at the hearing of the appeal. He claimed he had not filed incorrect returns.

### **Our decision**

22. Under section 82B(2) of the IRO, there are only three possible grounds of appeal. They are that:

- (a) the Appellant is not liable to additional tax;
- (b) the amount of additional tax assessed on the Appellant exceeds the amount for which the Appellant is liable under section 82A; and
- (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.

23. The onus of proving that the Assessments are excessive or incorrect is on the Appellant, sections 68(4) and 82B(3).

24. The Appellant’s contention that he had not filed incorrect returns is obviously unsustainable and we reject it. The Appellant objected to the additional salaries tax assessments dated 12 February 1998. By his determination dated 27 April 2001, the Commissioner confirmed the additional salaries tax assessments. The Appellant did not appeal against the determination. By reason of section 70 of the IRO, each of the additional salaries tax assessments as determined on objection is final and conclusive for all purposes of the IRO as regards the amount of such assessable income. The salaries tax returns submitted by the Appellant (paragraph 15 for the year of assessment 1991/92 and paragraph 8 for the years of assessment 1992/93 to 1994/95) omitted these incomes. The salaries tax returns submitted by the Appellant were clearly incorrect in that he had understated his income by \$161,720 for the year of assessment 1991/92, \$295,500 for the year of assessment 1992/93, \$264,000 for the year of assessment 1993/94 and \$120,000 for the year of assessment 1994/95.

25. The amounts of tax which had been undercharged in consequence of such incorrect returns or the amounts which would have been so undercharged if the returns had been accepted as correct are as follows:

| <b>Year of assessment</b> | <b>Amount undercharged</b> | <b>Tax undercharged</b> |
|---------------------------|----------------------------|-------------------------|
|---------------------------|----------------------------|-------------------------|

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|         | \$      | \$     |
|---------|---------|--------|
| 1991/92 | 161,720 | 35,244 |
| 1992/93 | 295,500 | 57,719 |
| 1993/94 | 264,000 | 51,800 |
| 1994/95 | 120,000 | 24,000 |

26. In our decision, there is no excuse (and most certainly, no reasonable excuse) for the Appellant to understate his incomes. We reject the excuses put forward by him in the amended note of interview and put forward at the hearing of the appeal.

- (a) By letter dated 11 June 1991, he wrote on behalf of Company B to the IRD in these terms (the following is written exactly as it stands in the original and we shall not punctuate it with ‘*sic*’):

‘ Application to waive profit tax of [Company B] from (File no. 04/12719962, Charge no. 1-2105215-90-4) 90 – 91 reason as follow:

- i) net lost of [Company B] from 89 – 90 \$300,000
- ii) net lost of [Company B] from 90 to present 120 万
- iii) Major income of the Company come from two of the Company retail shop; one already closed by March 91 and the other shop will close in Oct 91.

I shall turn in the management account of the Company within 40 days. Our company is now working on the round up procedure of the company. I deeply appreciate if you would accept our application.’

- (b) Although he seemed to have accepted initially that ‘round up procedure’ meant ‘winding up procedure’, he claimed that it meant that Company B would not continue trading. Even on the basis of the meaning attributed by him to ‘round up procedure’, this statement could not be reconciled with his case that by an alleged agreement dated 1 March 1991, Company B had contracted with Company C to provide consultancy services to Company C. If this alleged agreement was a commercially real agreement and had come into existence in about March 1991, he would not have told the IRD about ‘round up procedure’.
- (c) The Appellant stated that he did not wish to lend any money to Company B. We reject his assertion that Company B entered any alleged contract with Company C ‘for extra income’.



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- (d) Company B's financial statements showed that as at 31 March 1990 and 31 March 1991, the accumulated loss carried forward was \$932,912 and \$1,437,898 respectively. Instead of reporting his employment income from Company C, he claimed that it was Company B's 'trade commission' income. Had he succeeded, there would have been a substantial undercharge of tax.

27. Thus, the Appellant is liable to be assessed to additional tax in the years of assessment 1991/92 to 1994/95 and the Assessments do not exceed the amounts for which he is liable under section 82A.

28. Whether the Appellant agrees to face additional or penalty tax is irrelevant under section 82A. Having introduced an artificial transaction in an attempt to reduce his tax liability, he cannot reasonably expect all he needs to do is to pay his salaries tax which he should have paid years ago had he reported the correct amount of employment income. He should also have known that the 'interest' charged by the IRD was interest for not paying tax by the due date(s).

29. Each case depends on its own facts. The Assessments were assessed on the basis of 7% per annum compound for the delay in assessing him on the amounts of tax undercharged. We have carefully considered all the materials before us and come to the conclusion that none of the Assessments is excessive.

### **Disposition**

30. We dismiss the appeal and confirm the Assessments.

### **Costs order**

31. We are of the opinion that this appeal is frivolous and vexatious and an abuse of the process. Pursuant to section 68(9) of the IRO, we order the Appellant to pay the sum of \$5,000 as costs of the Board, which \$5,000 shall be added to the tax charged and recovered therewith.