Case No. D14/98

Penalty Tax – failure by a resigned employee to report chargeability to salaries tax – whether omission by the taxpayer was a genuine honest mistake – what factor(s) regard as reasonable excuse for omission – not every slip of the mind constitute a reasonable excuse for such omission – a matter of degree – look at all the circumstances of the case to decide whether the taxpayer had reasonable excuse – duty to make a full, complete, accurate and correct return – 10% penalty under section 82A of Inland Revenue Ordinance – inflation is not a good reason for increasing the percentage under section 82A of IRO.

Panel: Christopher Chan Cheuk (chairman), Edward Chow Kam Wah and Mathew Ho Chi Ming.

Date of hearing: 24 January 1998.
Date of decision: 16 April 1998.

The taxpayer resigned from Bank F, a company she worked with since her university graduation, and duly settled her tax affair before she went abroad for further education in 1990. Upon graduation with a MBA degree, the taxpayer returned to Hong Kong and joined Company E in 1992. During the period of employment, the taxpayer also received salary, director's fee and bonus from Company H, a company essentially owned by her father, of which she was a non-executive director. For the years of assessments 1992/93, 1993/94 and 1994/95, the taxpayer reported the incomes from both sources. In October 1995 she left Company E, whom she was then working as a senior manager. At about the same time, the taxpayer applied for holdover of provisional salaries tax for the year of assessment 1995/96 because she ceased her employment with Company E.

The taxpayer received a letter dated 8 November 1995 relating to her salaries tax for the year of assessment 1995/96 in standard printed form with the word "PROVISIONAL" in brackets type-written setting out, inter alia, the provisional tax held over and the balance payable. The taxpayer duly paid the amounts due on the respective dates mentioned therein.

On or about 1 May 1996, the taxpayer was sent a tax return for individuals for year of assessment 1995/96 which she completed. In section D therein, where the taxpayer was required to give details of income chargeable to salaries tax, she stated she was a director of Company H with an annual salary of $174,000 and director's fee of $60,000. The taxpayer omitted to mention her income from Company E for the assessment year 1995/96 where she worked as a senior manager up to 14 October 1995.

On 2 September 1996 an assessment was raised on the taxpayer's income of $519,619 from both sources for the year of assessment 1995/96. No objection was raised against the assessment.

On 23 May 1997, the Commissioner gave notice of his proposal to assess the taxpayer with additional tax to the taxpayer, who objected to such assessment.

On 18 June 1997 the Commissioner issued a notice of assessment for an additional tax of $12,000 which was the subject matter of the present appeal.

Held:

1. The Board did not consider the change of employment as the only cause regarded as reasonable excuse for omitting to report a part of his/her income in the tax return.

2. It was logical to say that not every slip of the mind constituted a reasonable excuse for such omission. It was a matter of degree which the Board has to decide. The graduation varied from simple lapse of memory to gross negligence.

3. In the present case, the taxpayer failed to disclose a sum equivalent to about 45% of her total income. If she had simply pleaded absent-mindness, the appeal would have been dismissed forthwith without further consideration.

4. The Board came to the conclusion that had it not been for the misconception as described by the taxpayer, she would not have omitted to report any part of her income.

5. The Board had to look at all the circumstances of the case to decide whether the taxpayer had reasonable excuse. There was no dispute that the taxpayer was careless. She had not been careful enough to read and analyze Section D of the return.

6. The Board accepted the general principle without reservation that every citizen has a duty to make a full, complete, accurate and correct return whenever required pursuant to the provisions of the IRO. However, the legislation does not intend to make it so absolute that every omission will be punished. It allows reasonable excuse as defence. In case of extenuating circumstances a taxpayer should be excused and not be penalised.

7. In the present case the taxpayer might not be able to pass the threshold of care as laid down by the Board in case D13/85; she did not exercise sufficient care and should have contacted the Revenue as she had done in 1990.

8. However, the Board has no hesitation to state that the omission by the taxpayer was a genuine honest mistake because at the time when the mistake was committed she was under the wrong impression that the part of income had been reported and needed not be repeated. The concept of provisional assessment could easily lead a person to think that the final assessment would be forthcoming after investigation by the Revenue and the taxpayer need not do anything more. At the same time she was also under heavy pressure of work and we accept as fact that she was working for the Chinese law examination. Any person under such circumstances would not have taken so much care as he should have done. The combined effect of misconception and the pressure of work caused the mistake. The mistake was excusable.

9. The penalty stating point for an simple omission where the taxpayer was a first offender and has no intent to evade tax and the Revenue has suffered no loss is 10% of the tax undercharged or which would have been undercharged.

10. Although the internal guideline of the Revenue Department had stipulated that the starting point for this type of offence was 25% of the tax undercharged, it was never published to the public. The Board was of the view that such guideline has no binding effect on any Board of Review cases. It has been commonly known that different Boards of Review have accepted the 10% as the starting point. The Board accepted the reason for the increase in penalty under subsections 80(1) and (2) was due to inflation. In such cases the cause of increase in percentage was due to the increase in the peralty sum and not due to any other reason. In the past all the penalty sums in form of additional tax under section 82A have been calculated in accordance with and pegged to percentage of tax undercharged. Inflation invariably meant that the taxpayer's income was increased and accordingly the tax undercharged as well as the additional tax would become higher. The Board found that inflation was not a good reason for increasing the percentage of tax undercharged as penalty under section 82A.

11. Should the Board be asked to assess the additional tax in this case, the Board were not prepared to take any percentage other that 10% as starting point and having considered the extenuating circumstances of this case, a percentage of 5% of the tax which would have been undercharged should be adopted.

Appeal allowed.

Case referred to:

D13/85, IRBRD, vol 2, 173

Tong Cheng Yuet Kiu for the Commissioner of Inland Revenue.
Kathy Wong of Messrs Kathy Wong & Co for the taxpayer.

Decision:

1. This is an appeal by Ms A, ('the Taxpayer') against assessment dated 18 June 1997 by the Commissioner of Inland Revenue on the Taxpayer for additional tax under section 82A(1) of the Inland Revenue Ordinance (the IRO) in the sum of $12,000 for the year of assessment 1995/96.

Proceedings

2. The following documents were produced by the parties respectively:

(A) By the Taxpayer and marked as exhibits in the following manner:

'A-1' Summary of Returns and Assessments for the years of assessments 1986/87 to 1996/97 in respect of the Taxpayer's income.

'A-2' Letter dated 20 September 1997 from Dr B of Company C.

'A-3' Letter dated 8 November 1995 from Mrs TONY CHENG Yuet-kiu to the Taxpayer.

'A-4' Letter dated 14 October 1995 from Mr D, the executive director of Company E.

(B) By the Revenue and marked in the following manner:

'R-1' A bundle of documents including the grounds of appeal and the statement of facts, the latter of which have been agreed.

'R-2' Salaries tax return, final assessment for the year of assessment 1990/91 dated 14 September 1990 relating to the Taxpayer.

3. Ms Kathy WONG acted for the Taxpayer and called the Taxpayer to give evidence under oath.

Facts of the Case

4. Most of the evidence given by the Taxpayer under oath is not in dispute. The facts of the case can be briefly summarised as follows:

(a) In 1986 shortly after graduation from the Chinese University the Taxpayer joined Bank F as bank officer and worked her way through with promotions until she resigned as deputy manager on 9 September 1990.

(b) On or about 1 May 1990 she received a return which she duly completed and returned on 31 May 1990. Some time in September 1990 before she left for Country G the Taxpayer went up to the Inland Revenue Department to settle her tax affair. Immediately she was asked by an assessor to complete a salaries tax return which she did (Exhibit 'R-2').

(c) Later, she was issued with two notices of assessments and notices for payment of provisional tax as set out in Exhibits A-1 pages 8 and 10. She duly paid the taxes before she left Hong Kong for Country G.

(d) After graduation with MBA degree she returned to Hong Kong and joined Company E in 1992. During the period of employment she also received salary, director's fee and bonus from a certain company known as Company H, a company essentially owned by her father, of which she was a non-executive director. For the years of assessments 1992/93, 1993/94 and 1994/95 she reported the incomes from both sources.

(e) In October 1995 she left Company E and her last position was senior manager.

(f) On or about 20 October 1995 she applied for holdover of provisional salaries tax for the year of assessment 1995/96 because she ceased her employment with Company E. A copy of her letter together with a copy of notification by her employer can be found on pages 12 and 13 of Exhibit R-1.

(g) The Taxpayer received a letter dated 8 November 1995 relating to her salaries tax for the year of assessment 1995/96 in standard printed form with the word 'PROVISIONAL' in brackets type-written setting out, inter alia, the provisional tax held over and the balance payable (Exhibit 'A-3'). The Taxpayer duly paid the amounts due on the respective dates mentioned therein.

(h) On or about 1 May 1996 she was sent a tax return – individuals for year of assessment 1995/96 which she completed. In Section D where she was required to give details of income chargeable to salaries tax she stated she was a director of Company H with an annual salary of $174,000 and director's fee of $60,000 (Exhibit 'R-1' page 16). She omitted to mention her income from Company E for the assessment year 1995/96 where she worked as senior manager up to 14 October 1995.

(i) On 2 September 1996 an assessment was raised on the Taxpayer's income of $519,619 from both sources for the year of assessment 1995/96 (Exhibit 'R-1' – page 19). No objection was raised against the assessment.

(j) On 23 May 1997 the Commissioner gave notice of his proposal to assess the Taxpayer with additional tax (Exhibit 'R-1' – page 20). In response to the notice the Taxpayer made representation (Exhibit 'R-1' – page 22).

(k) On 18 June 1997 the Commissioner issued a notice of assessment for an additional tax of $12,000 which is the subject matter of the present appeal.

Appeal

5. The Taxpayer by her tax representative Kathy WONG submitted detail grounds of appeal as set out on page 4 of Exhibit 'R-1' which can be summarised as follows:

(a) That the Taxpayer has a reasonable excuse and is not liable for the additional tax;

and (b) That the additional tax is excessive having regard to all the circumstances of the case.

Law

6. Section 82A(1) of the IRO clearly states:

'(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 … shall … be liable to be assessed under this section to additional tax of an amount not exceeding treble the amount of tax …'

7. The Taxpayer did not dispute the omission but argued that she had reasonable excuse. Ms Kathy WONG for the Taxpayer referred us to a Board of Review case D13/85, IRBRD, vol 2, 173 where it has been held that to be successful on the ground of reasonable excuse the taxpayer must have acted as a reasonable law-abiding citizen and exercised reasonable skill and care in handling his tax affairs such as one would expect from an average person and the mistake must be a genuine mistake without any intention to defraud or to avoid payment of tax.

Revenue Opposition

8. Mrs TONG for the Revenue gave several reasons for opposing the appeal against liability. First, she emphasized that in Section D of the return (Exhibit 'R-1' page 16) it was clearly stated *'details of income chargeable to Salaries Tax which accrued to me during the year'*. She submitted that the statement meant that all the incomes from whatever source during the assessment year 1995/96 should be reported. There was no reason for the omission and by the application for withholding payment of provisional tax the Taxpayer was not exonerated from disclosing that part of income from Company E. The Taxpayer did

not dispute her responsibility of reporting and what she argued was that she had reasonable excuse.

9. Mrs TONG further submitted that the Taxpayer had received high education and at the time of resignation in 1995 she was a senior manager, a person who should not have completed the return wrongly by omitting part of the income during the year. Further, Mrs TONY argued against the Taxpayer's claim that she was under pressure of work from Company E, her family and her studies and that even if it were true it did not constitute reasonable excuse.

Our Finding

10. Mrs TONG tried to distinguish the present case from D13/85 above cited: in the decided case the omission was caused by the taxpayer's change of employment and he omitted to report the particulars of employment. We do not consider the change of employment is the only cause which we should regard as reasonable excuse. In D13/85 the Commissioner himself accepted *'a simple slip of the mind'* in respect of a backpay of $4,645 as a reasonable excuse. But, it is only logical to say that not every slip of the mind constitutes a reasonable excuse. It is a matter of degree which the Board has to decide. The gradation varies from simple lapse of memory (like dropping one's umbrella or not having one's wallet in his pocket) to gross negligence (omitting to report a substantial amount of his income in the return). In the present case the Taxpayer failed to disclose a sum of $285,619 equivalent to about 45% of her total income. If the Taxpayer had simply pleaded absent-mindedness, the appeal would have been dismissed forthwith without further consideration.

11. Ms WONG for the Taxpayer pitched her appeal on a different ground: the Taxpayer worked under a misconception. The Taxpayer in her evidence said that she had experience of tax reporting at the time of termination of her employment. In 1990 before she left for Country G, she terminated her employment with Bank F. In or about 14 September 1990, she personally took the trouble of going to the office of Inland Revenue Department to finalize her tax position. During this visit to the Inland Revenue Department, she was asked to fill in and sign her salaries tax return, final assessment 1990/91 (Exhibit 'R-2'). The notice of assessment for the year of assessment 1990/91 was issued on 19 September 1990 (Exhibit 'A-1' page 10) and the tax was paid. In October 1995, she left her employment at Company E. This was her second experience in leaving an employment. However, she did not go to the office of the Inland Revenue Department this time. Instead she wrote (Exhibit 'R-1' pages 12 – 14). As a result of her written application, a notice of assessment 1995/96 (provisional) dated 8 November 1995 (Exhibit 'A-3') was issued. She thought that by applying for withholding tax the Revenue had record of her employment with Company E and she did not have to report. She did not realize that in her 1990 visit to IRD office she had already signed and filled in the final assessment for the year of assessment 1990/91. Further, she was not aware that in 1995, she had not yet filed in the final assessment for the year of assessment 1995/96 at the time when she mailed her application. Her misconception was strengthened by the fact that she was informed part of the tax being withheld and she was asked to pay provisional tax. Mrs TONG rightly pointed

out that the notice of assessment for the year of assessment 1990/91 was issued on 19 September 1990 (Exhibit 'A-1' page 10) was different from the one issued on 8 November 1995 (Exhibit 'A-3') both in form and wording and the word 'provisional' was clearly type written at the top of the letter.

12. The point we have to decide is whether the mistake was a genuine mistake. Ms Kathy WONG unrelentingly emphasized that her client was a law-abiding citizen and she prepared a summary of the Taxpayer's returns and assessment throughout the years from her first employment. She pointed out to us that except for the year in question the Taxpayer had never omitted a single item and every year she was assessed in the sum as stated in her return. We have had the opportunity of hearing the Taxpayer's oral testimony and seeing her demeanour. We have no doubt in our mind that she was a very conscientious person. This was supported by the written testimonial given by Mr D, the executive director of Company E (Exhibit 'A-4'). We come to the conclusion that had it not been for the misconception described in paragraph 11 she would not have omitted to report any part of her income.

13. We have to look at all the circumstances of the case to decide whether the Taxpayer had reasonable excuse. There is no dispute that the Taxpayer was careless. She had not been careful enough to read and analyse Section D of the return. She did not fully understand the effect of the letter dated 8 November 1995 (Exhibit 'A-3'). She thought that the Revenue had record of that part of income which she had reported by enclosing the employer's notification (Exhibit 'R-1' page 13). She had experience of reporting at the time of termination of employment and on that occasion she was not required to make further report. The Board accepts the general principle without reservation that every citizen has a duty to make a full, complete, accurate and correct return whenever required pursuant to the provisions of the IRO. However, the legislation does not intend to make it so absolute that every omission will be punished. It allows reasonable excuse as defence. In case of extenuating circumstances a taxpayer should be excused and not be penalised. In the present case the Taxpayer may not be able to pass the threshold of care as laid down by the Board in case D13/85; she did not exercise sufficient care and should have contacted the Revenue as she had done in 1990. But, we have no hesitation to state that the omission by the Taxpayer was a genuine honest mistake because at the time when the mistake was committed she was under the wrong impression that the part of income had been reported and needed not be repeated. The concept of provisional assessment can easily lead a person to think that the final assessment will be forthcoming after investigation by the Revenue and the taxpayer need not do anything more. At the same time she was also under heavy pressure of work and we accept as fact that she was working for the Chinese law examination. Any person under such circumstances would not have taken so much care as he should have done. The combined effect of misconception and the pressure of work caused the mistake. The mistake is excusable. For the reasons set out above, we allow the appeal against liability.

Quantum

14. In case as a matter of law our interpretation of reasonable excuse is overruled by a higher court, we have also considered the point of quantum. The penalty starting point for an simple omission where the taxpayer is a first offender and has no intent to evade tax and the Revenue has suffered no loss is 10% of the tax undercharged or which would have been undercharged.

15. Mrs TONG persuaded us to use a different starting point. She informed us that the legislature had amended subsections 80(1) and (2) by repealing the fine of $5,000 and substituting it with *'at level 3'* which according to section 113B of the Criminal Procedure Ordinance and Schedule 8 thereto means a fine of $10,000. Mrs TONG's argument was that as the legislature thought it fit to increase the fine it is logical to increase the penalty for similar kinds of offence. In fact the courts had increased the fines which represented much higher percentage of tax undercharged; Ms WONG submitted that there was no reason for the Commissioner not to increase the penalty for offences under section 82A. We were informed that by internal guideline which. Mrs TONG readily responded to the query by a member of the Board, was never published to the public, the Commissioner had stipulated that the starting point for this type of offence was 25% of the tax undercharged.

16. We must say that the Commissioner's guideline has no binding effect on any Board of Review. It has been commonly known that different Boards of Review have accepted the 10% as the starting point. The reason for the increase in penalty under subsections 80(1) and (2), we were told, was due to inflation. We accept this reason without doubt. In such cases the cause of increase in percentage was due to the increase in the penalty sum and not due to any other reason. In the past all the penalty sums in form of additional tax under section 82A have been calculated in accordance with and pegged to percentage of tax undercharged. Inflation invariably means that the taxpayer's income is increased and accordingly the tax undercharged as well as the additional tax will become higher. We find that inflation is not a good reason for increasing the percentage of tax undercharged as penalty under section 82A.

17. Should we be asked to assess the additional tax in this case we are not prepared to take any percentage other than 10% as starting point and having considered the extenuating circumstances of this case we shall reduce the rate at least by half, that is, 5% of the tax which would have been undercharged. The result will be $2,740.00 (that is, about 5% of $54,847).

Decision

18. For the reasons stated in paragraph 13 we have come to the conclusion that the Taxpayer has discharged her burden of proof that the Taxpayer had reasonable excuse. Therefore, we allow the appeal against liability and accordingly we order that the assessment made by the Commissioner of Inland Revenue on 18 June 1997 in respect of the additional tax of $12,000 on the Taxpayer be cancelled.