Case No. D179/98

Penalty Tax – whether a reasonable excuse for failure to notify chargeability and return assessable profits – whether penalty of approximately 100% excessive in the circumstances –section 82A(1) of the Inland Revenue Ordinance.

Panel: Andrew Halkyard (chairman), Kenneth Ting Woo Shou and Adrian Wong Koon Man.

Date of hearing: 25 February 1999.
Date of decision: 31 March 1999.

The taxpayer commenced employment as consultant with Company A, an offshore company, in Hong Kong in 1991. The taxpayer continued working in Hong Kong for Company A until 1995. For three of these four years the taxpayer failed to notify the Commissioner of the derived profits chargeable to profits tax from Company A. For the year of assessment 1993/94, the taxpayer reported that she derived 'nil' assessable profits.

The Inland Revenue Department commenced an investigation into the taxpayer's tax affairs on 12 May 1997. The taxpayer was interviewed on that date and tax returns for all relevant years were issued. The taxpayer took five months to complete the returns and in those returns she simply stated that her profits were 'nil'.

The taxpayer elected to give evidence. The taxpayer's consultancy contract with Company A provided that any tax liability upon her commission income was solely hers. The taxpayer however stated that the managing director of Company A, Mr C, informed her that this clause only applied to expatriates and not to Hong Kong residents. The taxpayer was further informed by Mr C that her commission income was not subject to tax in Hong Kong because she had an offshore employment with an offshore company and her income was paid by Company A offshore into an offshore bank account. The taxpayer was also told by Mr C that other consultants for Company A did not pay tax in Hong Kong. The taxpayer further claimed that she did not think again about whether she had any tax liability in Hong Kong because she was always too busy.

It was the taxpayer's case that the taxpayer had a reasonable excuse for failure to notify chargeability and return assessable profits and the penalty tax raised upon the taxpayer was excessive in the circumstances.

Held:

(1) The Board found that the taxpayer's failures to notify the Commissioner of chargeability and earning profits liable to profits tax were attributable to the cavalier attitude of the taxpayer to her tax compliance obligation.

(2) A causal canvassing of opinion on the tax liability of the taxpayer without any steps being taken to verify that opinion cannot constitute a reasonable excuse (D3/82, IRBRD, vol 2, 1 at 5, considered).

(3) The Board rejected the taxpayer's argument that the penalty tax should in total be the same regardless of the length that the failures or defaults being penalised persisted. The Board found that this was a case requiring some effort to finalise on the part of the Inland Revenue Department, that the profits went unreported for four years and were considerable. The Board was not convinced that the taxpayer was entirely cooperative throughout the investigation (D41/89, IRBRD, vol 4, 472 compared).

(4) Having considered the evidence and the facts, the Board concluded that the taxpayer has failed to convince the Board that the standard penalty of approximately 100% raised in this case for the failure of the taxpayer to comply with her taxation obligations under the Inland Revenue Ordinance for each of the four years under appeal was excessive (D53/88, IRBRD, vol 4, 10 compared).

Appeal dismissed.

Cases referred to:

D3/82, IRBRD, vol 2, 1
D41/89, IRBRD, vol 4, 472
D53/88, IRBRD, vol 4, 10

Tsui Siu Fong for the Commissioner of Inland Revenue.
Chiu Pak Kan of Messrs Raymond Chung & Co for the taxpayer.

Decision:

1. This is an appeal against assessments for amounts of additional or penalty tax imposed by the Commissioner under section 82A(1) of the Inland Revenue Ordinance.

The facts

2. The basic facts, which have been agreed by both parties and which we so find, are set out in a document produced to us entitled 'statement of facts'.

Evidence of the Taxpayer

3. The Taxpayer elected to give evidence before the Board. On the basis of that evidence and the various documents before us we make the following additional findings of fact.

1. For the four years up to and including the year of assessment 1994/95 the Taxpayer was a consultant of Company A, an offshore company. For three of these four years the Taxpayer failed to notify the Commissioner that she derived profits chargeable to profits tax from Company A. For the year of assessment 1993/94, after being sent a tax return for individuals, the Taxpayer simply reported that she derived 'nil' assessable profits.

2. The Taxpayer was recruited by Company A in Hong Kong in 1991. At this time the Taxpayer had no prior experience promoting and selling financial products. She was thus given one week's training. This took place in Hong Kong. Thereafter she gained experience on the job. After working for 18 months in Hong Kong she was sent to Country B for four days' additional training and to become more familiar with the operations of Company A worldwide. She then returned to Hong Kong and continued working here for Company A until 1995.

3. The Taxpayer's consultancy contract with Company A specifically provided that any tax liability upon her commission income was solely hers. The Taxpayer was aware of this provision when she signed the contract. In this regard she stated that the managing director of Company A, Mr C informed her that this clause only applied to expatriates and not to Hong Kong residents.

4. The Inland Revenue Department commenced an investigation into the Taxpayer's tax affairs on 12 May 1997. On that date she was called for an interview with an investigation officer and tax returns for all relevant years (including a duplicate return for the year of assessment 1993/94) were issued to her. She filed those returns with the IRD on 11 October 1997. In those returns she simply stated that her profits were 'nil'. The Taxpayer does not remember why she took five months to complete the returns. The only specific reason she mentioned was that she needed to obtain more information from Company A, including a copy of her consultancy contract, and that this took some time because her relations with the company were far from good.

5. The Taxpayer's failures to notify the Commissioner of chargeability and earning profits liable to profits tax (fact 1 refers) were attributable to the cavalier attitude she took to her tax compliance obligations. We now set

out the relevant facts together with our comments, where appropriate, thereon:

(a) When she commenced work with Company A, Mr C told her that her commission income was not subject to tax in Hong Kong because she had an offshore employment with an offshore company and her income was paid by Company A offshore into an offshore bank account.

Comments The Taxpayer gave no indication to us that she appreciated, or indeed cared, about the distinction between an employee and an independent consultant. Even if she was an employee (which she now agrees she was not), and even assuming she had an offshore employment, it would be obvious that her income should have been subject to salaries tax. There is no evidence to suggest, apart from the four days spent in Country B, that any of her commission was referable to services outside Hong Kong. She did not obtain any independent advice to verify Mr C's contentions.

(b) Mr C told her that he did not pay tax in Hong Kong. The Taxpayer was later told (she also believed this to be true) that the other consultants for Company A also did not pay tax in Hong Kong. They advised her to "keep a low profile".

Comments The Taxpayer was not particularly clear why this latter statement was made. Presumably the reason related to the IRD not making any unwelcome enquiries. In the event, the Taxpayer did keep a low profile and volunteered no information to the IRD until the investigation (fact 4 refers) commenced.

(c) After she commenced work with Company A, and after her initial conversation with Mr C, the Taxpayer did not think again about whether she had any tax liability in Hong Kong. She said she was 'always too busy'.

(d) When asked to justify her failures, the Taxpayer stated that she simply took the lead from her superiors in Company A. She said that it never crossed her mind to query the comments set out above concerning her tax position in Hong Kong.

(e) She did not pay tax in Country B, or any other jurisdiction, upon her commission income from Company A.

Comments In cross-examination, the Taxpayer revealed that she knew very well why she would not have been subject to tax in

Country B – she was not a resident and did not carry out her work there. By way of contrast, she displayed a singular lack of knowledge (or, indeed, any desire to gain knowledge) about the Hong Kong tax system.

Contentions of the parties

4. The Taxpayer's tax representative, Mr Michael Chiu of Raymond Chung & Company, relied upon the Taxpayer's oral evidence (see above) to show that (1) she had a reasonable excuse for failure to notify chargeability and return assessable profits and (2) in any event, the penalty tax raised upon the Taxpayer was excessive in the circumstances. The Commissioner's representative, Ms Tsui Siu-fong, vigorously opposed both claims.

Reasons for our decision

5. Our starting point was that, without reservation, we agree with Ms Tsui that in terms of section 82A(1) the Taxpayer had no reasonable excuse for the failures referred to in fact 1.

6. At best, the Taxpayer painted herself as extremely naïve and willing to accept everything Mr C said about her tax compliance obligations without any independent thought. Yet, even on this basis and accepting her evidence of her conversation with Mr C at face value, a casual canvassing of opinion on her tax liability without any steps being taken to verify that opinion cannot constitute a reasonable excuse (see D3/82, IRBRD, vol 2, 1 at 5). This conclusion is even more obvious in the circumstances of this case – where all the work undertaken to earn the Taxpayer's commission income took place in Hong Kong. Accordingly, whatever view the Taxpayer took of her legal relationship with Company A and the source of her commission income, it beggars reason to suggest that an objective observer would regard her explanations for her failures to comply with the Inland Revenue Ordinance as a reasonable excuse.

7. If necessary, we also note, with dismay, the Taxpayer's statements that she was 'always too busy' to think any more about any possible tax liability, that she accepted her colleagues advice to 'keep a low [tax] profile' and her clear explication about why she was not liable to tax in Country B in contrast to her views as to her Hong Kong tax liability. When these statements are given due weight in light of the other evidence and demeanour of the Taxpayer at the Board hearing, the justifications given by her to explain her tax compliance failures are as far removed from a reasonable excuse as could be imagined.

8. It follows that the sole issue before us is whether the penalty tax was, in terms of section 82B(2), excessive in all the circumstances.

9. This is an egregious case and, try as we could, we could not see any mitigating circumstances that should justify more lenient penalties than those imposed by the Commissioner. In short, during her oral testimony and cross-examination it became

increasingly clear that the Taxpayer's attitude towards her tax compliance obligations showed, to put in mildly, a cavalier disregarded for each and every one of them.

10. Mr Chiu tried hard to persuade us that the penalty tax assessed should not be the same percentage for each of the four years under appeal because the Taxpayer just made one mistake and should not therefore be penalised four times. But this is not a case of a simple and singular failure to report chargeability and assessable profits that starts and ends around the end of the first year of assessment (1991/92). Rather, the obligation to report chargeability and the existence of assessable profits is annual and ongoing. We cannot accept Mr Chiu's suggestion that the penalty tax should in total be the same regardless of the length that the failures or defaults being penalised persisted. Mr Chiu referred to no case authority to support his argument. We also do not know of any.

11. Mr Chiu then referred us to the fact that, unlike a normal investigation case where an assets betterment statement is prepared and which can drag on for a long period of time, the Taxpayer's case was relatively straightforward and was finalised within a short period of time. This argument, put in the context of justifying a lesser penalty, gave us pause for concern. But the fact remains that this was an investigation case requiring some effort to finalise on the part of the IRD, that the profits went unreported for four years and were considerable and, for the reasons given by Ms Tsui in her written submission, we were not convinced that the Taxpayer was entirely co-operative throughout the investigation (compare D41/89, IRBRD, vol 4, 472; see also fact 4).

12. Although we would not go as far as Ms Tsui to say that the Taxpayer entered into a deliberate scheme to conceal profit, the matters set out at fact 5 raise residual concerns that the Taxpayer was prepared to close her eyes to what appears more generally to border on fraudulent evasion. Not once did the Taxpayer indicate to us a clear appreciation that the way she conducted her taxation affairs was entirely inappropriate.

13. Having considered the evidence before us and the facts we have found, we conclude that the Taxpayer has failed to convince us that the standard penalty of approximately 100% raised in this case for her failure to comply with her taxation obligations under the Inland Revenue Ordinance for each of the four years under appeal was excessive (compare D53/88, IRBRD, vol 4, 10). The appeal is hereby dismissed.