

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D18/03

Penalty tax – failure to report income – shares in exchange for option to acquire share – quantum – whether excessive.

Panel: Kenneth Kwok Hing Wai SC (chairman), Sandy Fok Yue San and Lawrence Lai Wai Chung.

Date of hearing: 22 April 2003.

Date of decision: 15 May 2003.

The appellant omitted to report income, that is, gain from shares allotted to her in exchange for a share option to acquire shares in another company.

Additional tax was imposed upon her at \$8,400, that is, 11.1% of the amount of tax which would have been undercharged had the tax return been accepted as correct.

Held:

1. The Board found the appellant had no reasonable excuse for not reporting the option gain.
2. As to the quantum, the Board found the assessment was excessive. It was not a case that the appellant exercised the option to acquire shares. She was allotted shares in exchange for the option. The delay in tax collection was about two months. The appellant was also remorseful.
3. The Board found the assessment should be reduced to \$3,800 which was about 5% of the tax involved (D67/00 considered and distinguished).

Obiter:

The Board was of the view that the representative of the Revenue should inform it of any relevant decision, which she believed to be immediately in point, whether it be for or against her contention.

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Appeal allowed in part.

Cases referred to:

D112/97, IRBRD, vol 13, 31

D29/99, IRBRD, vol 14, 307

D67/00, IRBRD, vol 15, 643

Wong Yuen Wan Yee for the Commissioner of Inland Revenue.

Taxpayer in person.

Decision:

1. This is an appeal against the additional assessment dated 27 January 2003 by the Commissioner of Inland Revenue, assessing the Appellant to tax under section 82A of the Inland Revenue Ordinance (Chapter 112) ('IRO') for the year of assessment 2000/01 under charge number 9-2084574-01-7 in amount of \$8,400 ('the assessment').

2. The relevant provision is section 82A(1)(a) of the IRO for making incorrect return by omitting income, that is, the gain from the 'exercise' of a share option.

The agreed facts

3. The Appellant and the Respondent agreed the following facts and we find them as facts.

4. In the tax return - individuals for the year of assessment 2000/01, the Appellant declared the following income particulars:

Employer	Capacity	Period	Amount
			\$
First Employer	Administrator	1-4-2000 – 10-1-2001	253,935
Second Employer	Office manager	11-1-2001 – 31-3-2001	<u>93,038</u>
			<u>346,973</u>

5. On 19 November 2001, the assessor raised the salaries tax assessment for the year of assessment 2000/01 with the following assessable income:

Self income	<u>\$346,973</u>
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6. No objection was received from the Appellant against this assessment.

7. Examination of the employer's return by the assessor revealed that the Appellant had the following additional source of income from the Second Employer for the year of assessment 2000/01:

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Name of Employer	Amount of shares*
Second Employer	<u>Euro 60,189</u> (equivalent to HK\$444,375)

* This is written exactly as it stands in the agreed statement of facts. What it means is that the amount of notional gain, as at the date when the shares were placed at the Appellant's disposal, from the exchange of an option with shares was Euro 60,189.

8. On 30 January 2002, the assessor raised an additional salaries tax assessment on the Appellant for the year of assessment 2000/01 with the following income:

	\$
Additional income	<u>444,375</u>
Additional salaries tax	<u>75,544</u>

9. The Appellant lodged objection against the notice of additional assessment on 2 February 2002.

10. On 11 February 2002, the assessor unconditionally held over the additional salaries tax.

11. On 2 March 2002, the Appellant withdrew her objection. We interpose here to say that on 25 March 2002, the Appellant paid the additional salaries tax.

12. On 11 December 2002, the Commissioner of Inland Revenue gave notice to the Appellant under section 82A of the IRO that he proposed to assess the Appellant to additional tax in respect of the year of assessment 2000/01.

13. The Appellant made written representations on 13 December 2002 in response to the notice given by the Commissioner.

14. On 27 January 2003, the Commissioner, having considered the Appellant's representations, issued notice of assessment for additional tax under section 82A of the IRO for the year of assessment 2000/01 in the amount of \$8,400. The amount of additional tax charged represents about 11.1% of the amount of tax that would have been undercharged had the tax return for the year of assessment been accepted as correct.

15. The Board received the Appellant's appeal against the assessment for additional tax on 5 February 2003.

Revenue's selective citation of cases

16. At the hearing of the appeal, the Appellant appeared in person and the Respondent was represented by Mrs Wong Yuen Wan-ye, senior assessor.

17. Mrs Wong Yuen Wan-ye submitted a bundle of four documents, three of which had already been included as attachments to the statement of facts. Duplication is unhelpful.

18. Mrs Wong Yuen Wan-ye submitted a bundle of the following authorities:

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- (a) section 70 of the IRO;
- (b) D112/97 (no citation given);
- (c) section 9(1)(d) and section 9(4) of the IRO; and
- (d) D29/99 (no citation given).

19. Before the hearing began, the Chairman drew the parties' attention to D67/00, IRBRD, vol 15, 643. Mrs Wong Yuen Wan-ye told us that she was aware of D67/00.

20. We do not know if Mrs Wong Yuen Wan-ye is a barrister. If she is, her conduct is governed by paragraph 136 of the Code of Conduct of the Hong Kong Bar which provides that:

' In civil and, subject to the provisions of paragraph 154, in criminal cases, a barrister must ensure that the Court is informed of any relevant decision on a point of law or any legislative provision, of which he is aware and which he believes to be immediately in point, whether it be for or against his contention. '

21. The Commissioner of Inland Revenue is a party in every tax appeal before the Board. It is in the long term interests of the Commissioner to earn the Board's trust, confidence and respect.

22. It is also in the long term interests of every tax representative, whether representing the taxpayer or the Revenue, to build up a reputation with the Board as an able and reliable tax representative with undoubted integrity.

Our decision

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

24. The additional salaries tax assessment referred to in paragraph 8 above is final and conclusive under section 70.

25. The Appellant had no reasonable excuse for not reporting the option gain. She was quite forthcoming and told us that after she had been granted the option she made enquiries with the Inland Revenue Department ('IRD') and was advised that she had to report when the option became shares.

26. We turn now to the question whether the assessment is excessive.

27. The option was granted by the First Employer to the Appellant. After the Second Employer's group had acquired the First Employer, the Second Employer allotted shares in a group company in exchange for the option granted by the First Employer. It is different from the usual case where an option was granted by the taxpayer's employer and the taxpayer then decided on his own initiative to exercise the option and acquire shares. In this case, it was the Second Employer which made the decision to allot shares in one company in exchange for the option to acquire shares in another company. There was no conscious decision by the Appellant to exercise the option. It was the Appellant's first omission to report the option gain. The amount of the option gain or the income understated was \$444,375 and the ratio of income understated and the correct amount of income is $\$444,375 / (\$346,973 + \$444,375) = 56.15\%$. The due date for payment under the salaries tax

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assessment was 11 January 2002 and the due date for payment under the additional salaries tax assessment was 13 March 2002 so that the period of the delay in tax collection was about two months. The Appellant was remorseful.

28. In D67/00, the appellant was granted an option to acquire shares. In the year of assessment 1995/96, he exercised his option and acquired shares. He did not report his option gain. By letter dated 8 July 1996, he apologised to the IRD about his omission. In the year of assessment 1997/98 he exercised what remained of his option and acquired further shares. Again, he did not report his option gain. The amount of the option gain on the second occasion was \$3,815,240 and the ratio of income understated and the correct amount of income is $\$3,815,240 / \$5,595,240 = 68.19\%$. There was a delay of over six to nine months in the collection of the salaries tax from the appellant. The appellant was unrepentant and sought to blame the Revenue. The Commissioner imposed \$35,000 (6.8%) additional tax but the Board increased it to \$51,000 (slightly less than 10%).

29. Compared with D67/00, this is a far less serious case. In our decision, the assessment is excessive and should be reduced to \$3,800 which is about 5% of the tax involved.

Disposition

30. We allow the appeal and reduce the assessment to \$3,800.