INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D18/91

Penalty tax – reasonable excuse – taxpayer acting on professional advice – section 82A of the Inland Revenue Ordinance.

Panel: Denis Chang QC (chairman), Denis Evans and Kenneth Kwok Hing Wai.

Dates of hearing: 10 and 11 December 1990.
Date of decision: 6 June 1991.

Certain properties were acquired by the taxpayer and subsequently sold at a profit. The taxpayer did not declare the profit for profits tax purposes. The assessor assessed the profits to tax and the matter was taken on appeal to the Board of Review which found in favour of the Commissioner. Subsequent thereto additional tax by way of penalty was imposed upon the taxpayer on the basis that the taxpayer had without reasonable excuse made an incorrect profits tax return by failing to include therein or otherwise refer to the profits which he had made on the disposal of the properties. The taxpayer called to give evidence the professional accountant who had advised and prepared the tax return. The professional accountant gave evidence to the effect that she had held an honest belief that the profit was not subject to profits tax and this evidence was accepted by the Board of Review.

Held:

The mere fact that the taxpayer was acting upon professional advice does not necessarily mean that the taxpayer had a reasonable excuse for failure to comply with the requirements of the Inland Revenue Ordinance. It is necessary to look at the facts of each case. On the facts of the present case, the taxpayer had a reasonable excuse in all the circumstances.

Appeal allowed.

Case referred to:

CIR v Mayland Woven Labels Factory Ltd 1 HKTC 630

Lui Tat Ying for the Commissioner of Inland Revenue.
Johnny Lau Kam Cheuk of S Y Leung & Co for the taxpayer.

Decision:

This is an appeal against additional tax raised under section 82A of the Inland Revenue Ordinance, chapter 112.

The tax undercharged for the year of assessment 1981/82 was $6,927,484. The Commissioner has assessed the Taxpayer to additional tax in the amount of $1,500,000 representing 21.65% of the tax undercharged or 7.2% of the total maximum penalty provided for under section 82A.

The relevant notice of assessment and demand for additional tax was raised on the basis that the Taxpayer had, without reasonable excuse, made an incorrect profits tax return by failing to include therein or otherwise refer in the return to profits made on the disposal of various properties.

The properties in question were acquired jointly by the Taxpayer and Mr X between mid-1976 and mid-1980 and eventually combined into one large site for the purposes of a single redevelopment but were disposed of before building works commenced. The sale, which was to a third party property development group, was completed in April 1981 following a sales agreement entered into in October 1980.

It is the Taxpayer's case that there was reasonable excuse in not returning the profits on the sale of properties which he believed, on professional advice, to be capital assets, that is to say that they were acquired and held by the joint venture business for long term investment; and that both he and his tax representatives which prepared and submitted the return on his behalf saw no requirement to make reference in the return to the profits or the transaction which gave rise to them.

It is a fact that by the time the return complained of was made the Revenue knew that there was a disposal giving rise to gains. It is not in dispute that a schedule of rental income analysis together with a profit and loss account were submitted to the Revenue by the business for the year of assessment 1980/81; that on 15 February 1982 the assessor raised an enquiry on the Taxpayer's then tax representatives as to whether the rented properties had been disposed of. In the absence of a reply the assessor issued a notice under section 51(3) of the Inland Revenue Ordinance dated 14 June 1982 followed by an offer to compound for non-compliance in August 1982. On 26 October 1982 a reply to the enquiry was made by the then tax representatives on behalf of their clients that the subject properties 'had been disposed of in April 1981 at an aggregate price of $70,000,000'. That was before the relevant return had been made. The same representatives wrote to the Revenue on 2 November 1982 advising that they no longer acted for the Taxpayer and Mr X.

The Revenue raised two estimated assessments for the year of assessment 1981/82, the original or first assessment being dated 1 December 1982 in which the assessor estimated the profits at $21,000,000 and the second (additional) assessment being dated 14 December 1982 in which he estimated the profits at $33,000,000. Those estimated

assessments were made on the basis (although not so stated in the assessments) that the disposition in question took place and gave rise to taxable profits. The return made by the Taxpayer (which the Revenue complains of being incorrect) was accompanied by a letter dated 23 December 1982 from the Taxpayer's new tax representatives objecting to the two estimated assessments. The letter of objection stated, among other things, that the Taxpayer and Mr X had suspended their joint venture business since April 1981 and that there was no business activity since then. Accompanying the return was a certified profit and loss account for the period ended 28 April 1981 and supporting schedules. The letter requested that the tax be stood over pending the outcome of the objection.

The Assistant Commissioner on 18 January 1983 ordered an unconditional partial hold-over of profits tax. The Departmental Interpretation and Practice Note No 6 dated 10 January 1983 stated, inter alia:

> ' Tax will not be stood-over where the objection is considered at that stage to be frivolous or to have little merit, or if there are circumstances which may, if delay, create doubt as to ultimate collection or recovery of the tax. Where there is some real merit or substance in the objection, then only the amount of tax in dispute will be stood-over and any balance must be paid by the due date.'

In a letter dated 21 January 1983 to the Inland Revenue the Taxpayer's tax representatives contended that the properties had been held for rental collection for years and that the disposal of the properties was prima facie, a capital transaction. The same point was reiterated in a further letter from the tax representatives dated 7 February 1983. The tax representatives in the same letter promised to give details of the cost and the sales of the properties. Pursuant thereto, by a letter dated 10 March 1983 the tax representatives furnished the details promised and provided arguments as to why their clients considered that the disposal constituted a capital transaction and not subject to profits tax.

The objection was not determined by the Commissioner until 11 May 1988, that is more than five years after the letter of objection. The Commissioner confirmed the original 1981/82 profits tax assessment but revised the additional profits tax for that year to $4,085,410, making a total of $6,927,484. There was an appeal from the determination which was dismissed by the Board of Review in August 1989. An appeal by way of case stated was subsequently not proceeded with.

The Taxpayer cannot, of course, before this Board re-open the issues which have already been decided by the previous Board in August 1989. It does not, however, follow that because a taxpayer has been found to have made gains which ought to have been brought into charge the failure to include the gains as part of the assessable profits necessarily exposes the taxpayer to a penalty assessment.

The Revenue has in this appeal made it clear that had all the relevant information relating to gains made on the disposal of assets been included in the return no penalty assessment would have been raised. The Revenue nevertheless insists that it is not sufficient for the information to be given (even on a voluntary basis) shortly after the return

was made. It places great emphasis on the fact that the return was to be made on a specified form (BIR 52); that all sections of the form must be completed together with a certified copy of the balance sheet and profits and loss account of the business in respect of the basis period and full supporting schedules.

The Taxpayer disputes that the specified form required information relating to dispositions of capital assets to be included in the return itself. The Taxpayer himself did not give evidence; he is an old man apparently in poor physical health suffering from a long-standing lung disease as well as a hearing disability. However, Miss Leung, the sole proprietor of the Taxpayer's tax representatives, gave evidence. She was the person who personally handled the taxation matter for the Taxpayer. She said that the Taxpayer appeared to her to be in poor health but that she did obtain relevant information from him and personally discussed the matter with him. She said she formed the view that the properties in question were investment properties and advised her client accordingly although it was also clear to her that the Taxpayer himself already held the view that the properties were investment properties. She handled the matter of the return for him and maintained that if the properties were investment properties as she believed they were there was nothing which was incorrectly omitted from the return; that in any event, she was at the time raising objection to the estimated assessments which must have been made on the basis that the properties disposed of were not of a capital nature. She said that when making the return there was never any intention to keep the fact that the properties had been disposed of from the Revenue: it was a fact that the Revenue already knew. Neither was there any intention to keep other relevant information from the Revenue: shortly after the making of the return she proceeded to amplify the objection to the estimated assessments by advancing arguments that the disposition was of capital assets; and as mentioned above details of the cost of the properties and of the sales were supplied by her on 10 March 1983.

Miss Leung was cross-examined on accounting practices relevant to the making of the return: she firmly resisted any suggestion that she had acted in breach of any such practices. She was asked to give reasons why she considered that the properties in question were investment properties. This she did. At no time, however, was it put to her that she did not in fact form such view or that she could not honestly have reached the view which she did or that her view was otherwise unreasonable. In the course of the final submissions the Revenue indicated that they would apply to have Miss Leung recalled for further cross-examination; we indicated that we would be prepared to hear the application but before a date was fixed for hearing the application we were informed that the Revenue no longer wished to ask any further questions of Miss Leung.

The Board of course is not bound to accept evidence merely because a particular point has not been put to a witness and in evaluating the evidence of Miss Leung we have proceeded on the basis that the questions relating to accounting practices and on her reasons for advising that the properties were investment properties amounted at least implicitly to a challenge as to the reasonableness and propriety of her omitting from the return the gains made on disposal or information relevant thereto.

On the evidence before us, however, we are satisfied that Miss Leung was an honest witness. We find that she honestly and reasonably proceeded on the basis that in the particular circumstances of this case she did not have to include in the return itself the gains in the return or information relating thereto. When submitting the return she was at the same time objecting to estimated assessments from which it was apparent that the Revenue was contending that there were taxable gains made on disposition of properties; the Revenue clearly knew about the disposition which was the subject of the earlier letter to the Revenue dated 26 October 1982. Miss Leung intended to and did shortly afterwards amplify her client's objection to the assessments by providing more arguments and relevant information concerning the disposition, including the cost of the properties and details of the sales, information which she never intended to withhold from the Revenue in the first place.

We find that the Taxpayer, in the light of the professional advice he received and the fact that he reasonably left the matter of the form and manner of the return to Miss Leung, also acted reasonably and honestly in not having included the gains or information relating thereto in the return itself.

In reaching the above conclusions we have not ignored but have also taken into consideration the facts and matters upon which the previous Board of Review while reducing the amount of tax payable upheld the determination of the Commissioner that the properties were not capital assets. We note, in passing, that before the previous Board no evidence was called by the Taxpayer. Its findings in our view do not preclude the finding by us on the evidence now before us of the existence of an honest belief on the part of the Taxpayer and his tax representative at the time of the return that there was no obligation to include in the return gains made or information relating thereto. Neither does it preclude the finding of reasonable excuse insofar as that requires a consideration of matters which include but are not confined to subjective beliefs.

Our finding in no way detracts from the undoubted requirement of making a proper return with supporting information as stressed by McMullin J in CIR v Mayland Woven Labels Factory Ltd 1 HKTC 630. The mere fact that the taxpayer was acting upon professional advice would not necessarily furnish a reasonable excuse for failure to comply with the requirement; indeed the fact that he was assisted by professional advisers could sometimes make it more difficult for the taxpayer to put forward any reasonable excuse for not having made a correct return. Everything depends on the facts of each case. Here there was disclosure of the fact of disposition (and the aggregate proceeds) prior to the return, followed by further information shortly after the making of the return in circumstances in which estimated assessments had already been made prior to the return and objection thereto actively pursued by the Taxpayer who acted on professional advice throughout and reasonably left the manner and form of the return to the professional advisers who, as we have found, also acted honestly and reasonably throughout with no intention to withhold any requisite supporting information. The liability to penalty assessment is of course not dependent on any intention to deceive the Revenue; however in considering whether reasonable excuse existed all the circumstances of the case would have to be considered by reference to the particular omission in question.

Insofar as the profits had not been returned the return was ‘incorrect’ but we find that in all the circumstances of case there was reasonable excuse within the meaning of section 82A of the Ordinance.

For the above reasons we allow the appeal and discharge the assessment.