Case No. D23/00

Penalty tax – incorrect salaries tax return – two sources of income: business profits and salary income – failure to disclose salary income in tax return – whether a reasonable excuse existed under section 82A of the Inland Revenue Ordinance (' IRO') – demeanour of the taxpayer – 6% penalty under section 82A of the IRO.

Panel: Benjamin Yu SC (chairman), Ho Kai Cheong and Thong Keng Yee.

Date of hearing: 5 April 2000.
Date of decision: 14 June 2000.

For the year of assessment 1995/96 the taxpayer included both sources of his income, being business profits and salary income, in his tax return. After he had changed his tax representative, the taxpayer included his business profits but omitted to include his salary income in his subsequent two tax returns. Instead, he had written to the Revenue in both years informing it of the said salary income. The Revenue did not raise any query with the taxpayer as to this practice nor did it choose to levy additional tax against him. For the year of assessment 1998/99, the taxpayer continued the same practice although, instead of sending a letter to the Revenue, he sent to it his employer' s return which disclosed his salary income.

On 24 November 1999, the Commissioner issued a notice of additional tax under section 82A(4) in the amount of $20,000 whereby he took the view that, by omitting his salary income from his tax returns, the taxpayer had made incorrect returns to which there was no reasonable excuse. The taxpayer, although not challenging his liability to pay tax, had assumed that the Revenue had accepted his practice of the past two years since no objection had been raised thereon.

Held:

1. It was a duty of every taxpayer to report his or her income faithfully (D27/97 followed);

2. Although the taxpayer had no intention of evading his tax liability, a ' good record' or ' unfavourable economic situation' were irrelevant considerations for the Board;

3. The taxpayer had probably laboured under a false sense of security that the practice he had adopted was acceptable to the Revenue. It was not for the Revenue to warn the taxpayer of any irregular practice, although it was usual in such cases for the Board to

look at the taxpayer' s point of view. It was an innocent, although still punishable, mistake;

4. In all the circumstances, the additional tax to be paid would be reduced from $20,000 to $13,000.

Appeal allowed in part.

Cases referred to:

D27/97, IRBRD, vol 12, 210
D9/98, IRBRD, vol 13, 103
D14/98, IRBRD, vol 13, 153

Lee Ho Wing Man for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

The appeal

1. This is an appeal by the Taxpayer against an assessment of additional tax in the sum of $20,000 made by the Commissioner of Inland Revenue on 24 December 1999.

The facts

2. The Taxpayer gave evidence before us. From his evidence and the documentary materials before us, we find the following facts. These are in any event not in dispute.

(1) During the relevant years of assessment, that is, 1995/1996 to 1998/1999 inclusive, the Taxpayer received income from two sources:

(a) profits derived from his sole proprietorship business in the name of Company A (hereinafter referred to as his ' business profits'), and

(b) salary from two companies in which he is interested in, namely, Company B and Company C (hereinafter referred to as his ' salary income').

(2) For the year of assessment 1995/96, the Taxpayer reported both sources of his income in his tax returns.

(3) For the years of assessment 1996/97 and 1997/98, the Taxpayer only reported his business profits in his tax returns. He did, however, inform the Revenue of his salary income by letters sent some three months after the submission of his returns. The Revenue did not query this practice, and had not sought to levy additional tax on his failure to report his salary income in his tax returns for the years of assessment 1996/97 and 1997/98.

(4) For the year of assessment 1998/99, the Taxpayer again reported only his business profits, and omitted to report his salary income. He did not inform the Revenue of his salary income by letter. However, he had, prior to the submission of his tax returns, duly completed and furnished to the Inland Revenue Department the employer's return of remuneration and pensions in which he reported, in his capacity as a director of Company B and of Company C, the amounts of his salary income during this year of assessment.

(5) The amounts of the Taxpayer's salary income which he failed to report in his tax returns for the three relevant years of assessment were as follows:

Year	**Source**	**Amount** **$**
1996/97	Company B	390,000
	Company C	468,650
1997/98	Company B	450,000
	Company C	633,082
1998/99	Company B	714,000
	Company C	793,471

(6) On 14 September 1999, the Taxpayer was assessed in respect of both his business profits and salary income at $1,507,471 with tax payable thereon of $217,210. The assessor obtained information as to the Taxpayer's salary income from the employer's returns. The Taxpayer did not object to this assessment.

(7) On 24 November 1999, the Commissioner issued a notice of additional assessment under section 82A(4), by which the Taxpayer was informed that the Commissioner was of the opinion that he, that is, the Taxpayer, had without reasonable excuse, made incorrect tax returns for the year of assessment 1998/99 by omitting the salary income.

(8) Having considered the Taxpayer' s representation by letter dated 25 November 1999, the Commissioner assessed the additional tax at $20,000. This was roughly equivalent to 10% of the tax which would have been undercharged if his omission had gone unnoticed.

The Taxpayer' s explanation and plea of leniency

3. The Taxpayer accepted that the Commissioner was entitled to assess additional tax on him, but pleaded for leniency. He gave evidence to the following effect:

(1) He was aware of the need to report all his income in his returns. Thus, in his returns for the year of assessment 1995/96, he duly reported both sources of his income.

(2) Thereafter, he changed his tax representative, and because he did not wish to divulge to this new tax representative his salary income, he only passed on his business profits to the tax representative, and thought that by writing the letters to the Revenue to report his salary income, he would have remedied the deficiency. He accepted that he did not consult the Revenue on this. But equally, he was not advised by the Revenue at any time during the years of assessment 1996/97 to 1997/98 that what he did was in any way improper or irregular.

(3) For the year of assessment 1998/99, he explained that he was about to write a letter to inform the Revenue of his salary income when he received the notice of assessment on 14 September 1999. Upon reading the notice, he came to the conclusion that the Revenue had correctly assessed both his business profits and salary income, and thought there was no need for him to send off the letter.

4. In his notice of appeal, the Taxpayer relied, *inter alia*, on the fact that the Revenue had not given him any warning that the practice he adopted was in breach of section 82A(1), as a result of which he thought that so long as he did not conceal his income, the practice he adopted was acceptable to the Revenue. He also submitted that $20,000 was not a small amount, and given the downturn in the economy in general, and his having faithfully reported his tax liability for the past 30 years, he pleaded for a reduction of the additional tax to $2,000.

The Revenue' s arguments

5. Mrs Lee for the Commissioner accepted that the Taxpayer had no intention of evading his tax liability. She drew our attention to the decision of the Board in D27/97, IRBRD, vol 12, 210 at 214 (paragraph 17) which stated that ' good record' and unfavourable economic condition were irrelevant considerations. We would point out that the Board was there dealing with the

liability to pay additional tax, rather than the quantum.

6. Mrs Lee stressed that it was the duty of every taxpayer to report his or her income faithfully, relying on the observations of the Board in D27/97. She submitted that the Taxpayer ought to have known of his duty. She drew our attention to previous decisions of the Board (D9/98, IRBRD, vol 13, 103 and D14/98, IRBRD, vol 13, 153) to the effect that 10% of the tax undercharged was regarded as the starting point for cases where the taxpayer was a first offender and the mistake was unintentional.

Our findings and decision

7. Since the Taxpayer does not contest his liability to pay additional tax, we are concerned only with quantum in this appeal. By his acceptance of liability, the Taxpayer has, correctly in our view, accepted that his omission was without reasonable excuse. His reason for not wanting his tax representative to know about his salary income does not in any way justify that omission.

8. The Revenue has accepted that the Taxpayer had no intention of evading his tax liability. We have no hesitation in agreeing with this view on the facts of this case. In respect of the year of assessment in question, the Taxpayer had, although in a different capacity, reported the relevant salary income in the employer' s return for Company B and Company C.

9. Having observed the Taxpayer gave evidence, we accept his evidence that he would have sent off a letter to notify the Revenue of his salary income had he not received the notice of assessment. He was perhaps guilty of dilatoriness in not having done this earlier.

10. We accept that the starting point for cases of this type is 10% of the tax undercharged. Nevertheless, this is only a starting point, and we must consider the facts of the present case to determine whether the charge of 10% in the present case is excessive. Put another way, we ask ourselves whether there are extenuating circumstances as were found in D14/98. Each case must, of course, turn on its own facts. Having considered all the circumstances, in particular, that the Taxpayer might well have laboured under a false sense of security that the practice he adopted in the previous two years of assessment was not unacceptable to the Revenue, we would reduce the additional tax to a sum of $13,000. This is approximately 6% of the tax which would have been undercharged if the omission was not discovered. (This also happens to be approximately 10% of the amount of tax in respect of the amount of income under-reported in the Taxpayer' s returns for the year of assessment 1996/97; and would have been the approximate level of additional tax if the Taxpayer had been assessed under section 82A in respect of his earlier omission.) In so reducing the additional tax, we must not be taken to suggest that the Revenue should bear any blame for not having warned the Taxpayer of his irregular practice, but we consider it right, when it comes to a question essentially of penalty, to consider the matter from the perspective of the Taxpayer.

11. In the event, we allow the appeal to the extent of reducing the additional tax from $20,000 to $13,000.