

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D26/89

Penalty tax assessments – whether quantum of penalties excessive – section 82A of the Inland Revenue Ordinance.

Panel: William Turnbull (chairman), Andrew J Halkyard and Patricia Loseby.

Date of hearing: 26 May 1989.

Date of decision: 24 July 1989.

The taxpayer carried on business as a painting sub-contractor. He was a small businessman who did not maintain adequate accounts. Following inquiries made by the assessor, an assets betterment statement was prepared and ultimately accepted by the taxpayer. The outstanding tax assessments were settled on the basis of the agreed assets betterment statement. After the tax affairs of the taxpayer had been settled, the Deputy Commissioner imposed penalty tax assessments upon the taxpayer in respect of the five years in question, 1979/80 to 1983/84 inclusive on the ground that the taxpayer had filed incorrect returns. The total tax undercharged amounted to \$36,654. The total amount of the penalty tax assessments was \$51,200.

Held:

The quantum of the penalty tax assessments was excessive. In a case of this nature involving a small business person whose business was not sophisticated and who had not been fraudulent or attempt to evade tax, the appropriate penalty would be equal to the tax undercharged.

Appeal allowed in part.

Ricky Wong for the Commissioner of Inland Revenue.

Lau Kam Cheuk of Ready Secretaries & Nominees Ltd for the taxpayer.

Decision:

This is an appeal by the Taxpayer against certain additional assessments to tax raised on him under section 82A of the Inland Revenue Ordinance.

The facts are as follows:

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1. The Taxpayer was carrying on business as a painting sub-contractor.
2. The Taxpayer filed a profits tax return for the year of assessment 1979/80 on 12 August 1980 which was accepted by the assessor and an assessment was made accordingly.
3. When the Taxpayer failed to submit a profits tax return for the year of assessment 1980/81 the assessor raised an estimated assessment under section 59(3) of the Inland Revenue Ordinance on the Taxpayer on 29 October 1981 on assessable profits of \$50,000. On 19 January 1982 the Taxpayer filed a profits tax return for the year of assessment 1980/81 which showed assessable profits of \$45,898. The Taxpayer did not object to the estimated assessment because he had changed his address and did not receive the assessment in time.
4. When the Taxpayer failed to submit a profits tax return for the year of assessment 1981/82 the assessor raised an estimated assessment under section 59(3) of the Inland Revenue Ordinance on the Taxpayer on 31 August 1982 on assessable profits of \$100,000. A notice of objection was filed on behalf of the Taxpayer against this estimated assessment by his tax representatives, on 30 September 1982. A profits tax return was submitted with this objection in which the Taxpayer stated his assessable profits for the year of assessment 1981/82 as \$16,854. Correspondence took place between the assessor and the representatives for the Taxpayer and on 26 April 1983 the Taxpayer agreed to settle the matter and to accept the assessment on the estimated profit of \$100,000.
5. When the Taxpayer failed to submit a profits tax return for the year of assessment 1982/83 the assessor raised an estimated assessment under section 59(3) of the Inland Revenue Ordinance on the Taxpayer on 30 March 1984 on assessable profits of \$120,000. A notice of objection was filed on behalf of the Taxpayer by his tax representatives, on 31 January 1985. A profits tax return was submitted with this objection in which the Taxpayer stated his assessable profits for the year of assessment 1982/83 as \$13,712. On the same date the Taxpayer also filed a profits tax return for the year of assessment 1983/84 in which he stated his assessable profits to be \$53,719.
6. The assessor caused enquiries to be made into the financial affairs of the Taxpayer. During the course of these enquiries further additional assessments for 1979/80 and 1980/81 and an estimated assessment for the year 1983/84 were raised on the Taxpayer in the following amounts:

<u>Year of Assessment</u>	<u>Additional/ Estimated Profit</u>	<u>Date of Issue</u>
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\$

1979/80	150,000	13-3-1986
1980/81	350,000	19-2-1987
1983/84	150,000	19-2-1987

The Taxpayer lodged valid notices of objection against the above assessments.

7. On 15 October 1986 the Taxpayer attended an interview at the Inland Revenue Department when a draft assets betterment statement was shown to the Taxpayer covering the period from 1 January 1979 to 31 December 1983 and which showed a discrepancy of around \$380,000. The Taxpayer said that he would go over his records and seek professional advice regarding the discrepancy. The former tax representatives of the Taxpayer refused to continue to represent the Taxpayer and he was obliged to instruct new representatives.
8. On 23 February 1987 the Taxpayer appointed new tax representatives. By letter dated 30 March 1987 the assessor requested the Taxpayer to furnish information in respect of the job revenue which the Taxpayer had reported in the accounts which he had prepared for the years ended 31 December 1979 to 31 December 1983.
9. On 26 May 1987 the Taxpayer and his new tax representatives attended at the Inland Revenue Department when they gave replies to some of the questions raised by the assessor but did not answer all of the assessor's questions. They requested the Inland Revenue Department to put in writing the questions requiring answers. By letter dated 3 June 1987 the assessor raised further enquiries on the Taxpayer in respect of his affairs in connection with the period from 1 January 1979 to 31 December 1985. The new tax representative decided not to continue to assist the Taxpayer.
10. On 1 October 1987 the Taxpayer and his wife attended the Inland Revenue Department and they again attended the Inland Revenue Department on 17 November 1987. At this second interview the Taxpayer and his wife were shown an assets betterment statement covering the period from 1 January 1979 to 31 December 1983 which revealed that the amount of profit understated by the Taxpayer was \$387,975. After negotiations the officers of the Inland Revenue Department agreed to reduce the amount of the understatement to \$302,975, taking into account certain expenses which the Taxpayer said had been omitted.
11. On 11 December 1987 revised additional assessments for the years of assessment 1979/80 and 1980/81 together with revised assessments for the

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years of assessment 1982/83 and 1983/84 were issued on the basis of the sum of \$302,975 which the Taxpayer had agreed to accept.

12. The Deputy Commissioner was of the opinion that the Taxpayer had without reasonable excuse made incorrect returns for the years of assessment 1979/80 to 1983/84 inclusive and gave notice of his intention to assess additional tax under section 82A of the Inland Revenue Ordinance. The Taxpayer submitted representations to the Deputy Commissioner and after taking into account these representations the Deputy Commissioner made the following additional tax assessments under section 82A on the Taxpayer:

<u>Year of Assessment</u>	<u>Profits as per returns</u> \$	<u>Profits assessed after investi- gation</u> \$	<u>Tax Under- Charged</u> \$	<u>Section 82A Additional Tax</u> \$
1979/80	23,104	35,741	1,896	2,800
1980/81	45,898	161,099	22,050	33,000
1981/82	16,854	100,000	2,325	2,500
1982/83	13,712	69,698	1,381	1,500
1983/84	<u>53,719</u>	<u>89,724</u>	<u>9,002</u>	<u>11,400</u>
	<u>153,287</u>	<u>456,262</u>	<u>36,654</u>	<u>51,200</u>

13. On 3 March 1988 the Taxpayer gave notice of appeal against these section 82A assessments.

At the hearing before the Board of Review the representative of the Taxpayer appeared and challenged a number of facts set out in a statement of facts which had been prepared by the representative for the Commissioner. In finding the facts as we have in this decision we have taken into account the representations made by the representative for the Taxpayer so far as we consider them to be valid.

After careful consideration of the facts and the submissions made before us we find that the additional assessments levied under section 82A by the Deputy Commissioner are excessive in the light of all of the circumstances.

This is a border line case and depends to a large extent upon the degree of co-operation given by the Taxpayer in the course of the enquiries which were made by the Inland Revenue Department and whether or not there is evidence of the Taxpayer having been fraudulent or having attempted to evade tax.

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It was not argued before us that the Taxpayer had been fraudulent or intentionally tried to evade payment of tax. Rather this is a case of a taxpayer who has failed in his obligations under the Inland Revenue Ordinance to keep proper accounts.

In a number of previous decisions the Board of Review has decided that an appropriate starting point for assessing additional tax by way of penalty under section 82A is an amount equal to the tax under-charged or 1/3 of the maximum penalty. This is the appropriate penalty in a case where a taxpayer has totally failed in his obligations under the Inland Revenue Ordinance to maintain proper accounts and file proper tax returns but has not attempted to evade payment of tax or been fraudulent and also has shown reasonable co-operation when the matter has been drawn to the attention of the taxpayer and the matter has been investigated by the Inland Revenue Department.

In the case before us the Taxpayer instructed professional advisers to represent him in his affairs. On two occasions his advisers declined to represent him further and ultimately he settled the matter personally with the Inland Revenue Department when he agreed to accept a revised assets betterment statement. This is not a case of a large businessman running a sophisticated business but of a painting sub-contractor earning income from jobbing.

On the facts before us this case would not appear to be any better or worse than a number of other cases which have come before us and in which lesser penalties have been imposed. As we have stated it is a borderline case because the Taxpayer had already had problems with his tax affairs for the year of assessment 1981/82 when he agreed to accept an assessment substantially higher than the amount stated in his tax return. That should have put him on notice that his accounting systems and records were inadequate. The fact that he continued to file tax returns disclosing very small assessable profits can, in the absence of fraud or dishonesty, only be described as foolish. Here again he should have known that something was wrong. Clearly there should be substantial penalties imposed in such circumstances. It is the duty of all taxpayers to file true and correct tax returns. Our system of taxation will collapse if this obligation is eroded. However we must also bear in mind the nature of the Taxpayer and his business and all of the facts of the case. On the basis of the facts before us it would appear that the amount of the penalties imposed by the Deputy Commissioner are excessive and we order that the same be reduced as follows:

<u>Year of Assessment</u>	<u>Reduced Amount of S 82A Additional Tax</u>
	\$
1979/80	1,896
1980/81	22,050
1981/82	2,325
1982/83	1,381
1983/84	<u>9,002</u>
	<u>36,654</u>