

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D27/89

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

Panel: William Turnbull (chairman), Henry Tang Ying Yen and Kenneth Ting Woo Shou.

Date of hearing: 22 June 1989.

Date of decision: 1 August 1989.

The taxpayer was the sole proprietor of a business manufacturing photo albums. He filed various tax returns for the years 1979/80 to 1984/85 inclusive. His tax affairs were reviewed by the Inland Revenue Department and it was agreed between the taxpayer and the assessor that he had understated his profits by a total of \$600,000. The taxpayer was then assessed to additional tax for each of the years in question with the sum of \$600,000 being apportioned in equal shares to each of the six years in question. Following the settlement of the tax affairs of the taxpayer, the Deputy Commissioner imposed penalty tax assessments totalling \$159,900 on the taxpayer because he had filed incorrect tax returns.

Held:

The quantum of the penalty tax assessments was excessive. The taxpayer was a small businessman and the appropriate penalty would be an amount equal to the tax undercharged. The Board rejected a submission by the taxpayer that his financial status subsequent to the years in question should be a mitigating factor.

Appeal allowed in part.

Ricky Wong for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

This is an appeal by a taxpayer against a number of additional assessments to tax imposed upon him under section 82A of the Inland Revenue Ordinance.

The facts are as follow:

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1. The Taxpayer was the sole proprietor of a business which commenced in January 1978 as a manufacturer of photo albums and ceased in March 1988.
2. The Taxpayer filed various tax returns for his business as follows:

<u>Year of Assessment</u>	<u>Date of Filing</u>	<u>Return Profits</u> \$
1979/80	25-6-1980	28,190
1980/81	27-6-1985	69,022
1981/82	27-6-1985	38,982
1982/83	27-6-1985	58,789
1983/84	18-8-1984	36,362
1984/85	26-6-1985	76,762

3. On 14 May 1985 the Taxpayer attended an interview at the Inland Revenue Department when he was told that his tax affairs were being reviewed. Profits tax return forms for the years of assessment 1980/81 to 1982/83 and for the year 1984/85 were issued to the Taxpayer for completion.
4. In the course of the investigation the Taxpayer proposed during an interview on 4 November 1985 to settle his case by paying tax of about \$10,000 per year. The Inland Revenue Department rejected this proposal.
5. On 18 November 1986 the Taxpayer made another proposal in writing to settle his case as follows:

<u>Year of Assessment</u>	<u>Revised Assessable Profits</u> \$
1979/80	92,995
1980/81	102,295
1981/82	112,524
1982/83	123,777
1983/84	136,155
1984/85	<u>149,770</u>
Total	<u>717,516</u>

6. On 27 October 1987 the Taxpayer agreed to settle the case on a total discrepancy of \$600,000 for the years of assessment 1979/80 to 1984/85. On 17 November 1987 revised assessments for the years of assessment 1979/80 to 1980/81 together with assessments for the years of assessment 1981/82 to 1984/85 were issued based on the agreed profits.

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7. The following is comparative table of the assessable profits before and after investigation and the amount of tax undercharged:

<u>Year of Assessment</u>	<u>Profits as per the Returns filed</u> \$	<u>Profits assessed after investigation</u> \$	<u>Profits understated</u> \$	<u>Tax undercharged</u> \$
1979/80	42,589	142,589	100,000	19,647
1980/81	69,022	169,022	100,000	21,404
1981/82	65,382	165,382	100,000	17,720
1982/83	58,789	158,789	100,000	16,072
1983/84	66,362	166,362	100,000	17,965
1984/85	<u>76,762</u>	<u>176,762</u>	<u>100,000</u>	<u>20,452</u>
Total	<u>378,906</u>	<u>978,906</u>	<u>600,000</u>	<u>113,260</u>

8. 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 1984/85 inclusive and gave notice to the Taxpayer of his intention to assess additional tax under section 82A of the Inland Revenue Ordinance.
9. After taking into account the representations filed by the Taxpayer the Deputy Commissioner on 15 March 1988 made the following additional tax assessments under section 82A on the Taxpayer:

<u>Year of Assessment</u>	<u>Tax undercharged</u> \$	<u>Section 82A Additional Tax</u> \$
1979/80	19,647	29,400
1980/81	21,404	32,100
1981/82	17,720	26,500
1982/83	16,072	22,700
1983/84	17,965	23,800
1984/85	<u>20,452</u>	<u>25,400</u>
Total	<u>113,260</u>	<u>159,900</u>

10. On 20 April 1988 the Taxpayer gave notice of appeal against the additional section 82A tax assessments.

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At the hearing of the appeal the Taxpayer appeared on behalf of himself and explained that he had had to close his business. He said that he was a law abiding citizen with limited education. He said that he only knew how to work hard and had all along authorised other persons to handle his tax affairs. He pointed out that he had not wilfully evaded tax.

He said that he was now working for another company earning \$5,000 per month and that two of his children were working and gave him \$1,000 per month for family living expenses so that his current total income was only \$7,000. He said that he had already paid additional tax of \$40,000 by instalments and had now applied to the Inland Revenue Department to pay by instalments of \$3,000 per month but the Inland Revenue Department had not accepted his proposal. He said that he had no savings and applied for cancellation or decrease of the amount of the section 82A penalty assessments.

The Commissioner's representative informed the Board that this case had been settled not on an assets betterment statement basis but by ascertaining what was the total turnover of the Taxpayer's business and then applying to that turnover a gross profit rate which was the gross profit rate provided by the Taxpayer.

The Board has considerable sympathy for the Taxpayer in this case because he is clearly not a large sophisticated businessman but someone who was running a small business which has not proved to be successful. While it is important that the integrity of our system of taxation must be protected, we are of the opinion that the penalties imposed under section 82A in this case are excessive having regard to all of the circumstances.

This case is similar to other cases which have come before Board of Review when it has been accepted that the basic penalty should be an amount equal to the amount of tax undercharged. In the circumstances of this case total penalties of the amount of tax undercharged are very substantial for this Taxpayer. Indeed we wonder whether the Taxpayer will be able to afford to pay even penalties of this magnitude. However, as the representative for the Commissioner said, the penalties are imposed because the Taxpayer failed to file true and correct returns and are not based on his current ability to pay. The fact is that the Taxpayer did substantially underdeclare his profits and had the benefit of the tax which he deferred, contrary to the law. The Inland Revenue Ordinance imposes substantial penalties in such circumstance and we consider that an appropriate penalty in this case is an amount equal to the tax undercharged.

Accordingly we order that the section 82A additional tax assessment appealed against be reduced to the following sums:

<u>Year of Assessment</u>	<u>Revised section 82A Additional Tax</u>
	\$
1979/80	19,647

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1980/81	21,404
1981/82	17,720
1982/83	16,072
1983/84	17,965
1984/85	<u>20,452</u>
Total	<u>113,260</u>