

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D27/92

Penalty tax – incorrect profits tax returns – quantum of penalties – section 82A of the Inland Revenue Ordinance.

Panel: William Turnbull (chairman), Kenneth Ting Woo Shou and David Wu Chung Shing.

Date of hearing: 14 July 1992.

Date of decision: 25 September 1992.

The taxpayer was carrying on business and filed tax returns. The Inland Revenue Department investigated the taxpayer's affairs which revealed that the taxpayer had submitted incorrect profits tax returns and additional tax and penalties were imposed. Subsequently the Inland Revenue Department investigated the tax affairs of the taxpayer on a second occasion immediately following the first investigation. It was revealed that the taxpayer had again filed incorrect tax returns for the years of assessment 1983/84 to 1989/90 inclusive. The Commissioner of Inland Revenue imposed penalties under section 82A of the Inland Revenue Ordinance equal to 141% of the tax undercharged and totalling \$1,730,200. The taxpayer appealed against these penalty tax assessments and submitted that he had no intention to evade tax, that the second investigation was in reality a continuation of the first investigation, and that he had suffered because he had been restrained from leaving Hong Kong which had damaged his business. He further submitted that he had a low education level and had problems with his accounting staff.

Held:

The taxpayer was the author of his own misfortune and that the conduct of the taxpayer had come very close to evasion of tax which would have been a criminal matter. A person who carries on business in Hong Kong is responsible to keep true and correct accounts of his business. The taxpayer was not an unsophisticated shopkeeper or businessman. In the circumstances the penalties were not excessive.

Appeal dismissed.

Lai Chi Lai Ming for the Commissioner of Inland Revenue.

Taxpayer in person.

Decision:

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This is an appeal by a taxpayer against a number of penalty tax assessments made against him under section 82A of the Inland Revenue Ordinance.

The facts of the case are as follows:

1. The Taxpayer was the sole proprietor of a business ('the business') which he took over from his father on 1 January 1976. The business ceased on 31 July 1989. The business comprised the wholesaling of electrical appliances and materials. The business was carried on at a shop in Site A with a branch shop in Site B.
2. The Taxpayer and his wife also owned a private limited company incorporated in Hong Kong ('the company') which was incorporated on 13 July 1984. The company also sold electrical appliances and materials and carried on business at a shop in Site C. It took over the branch shop of the business when the business ceased trading on 31 July 1989.
3. In January 1983 the Inland Revenue Department commenced an investigation into the affairs of the Taxpayer. The investigation was completed in November 1985 and revealed that the Taxpayer had submitted incorrect profits tax returns for the years of assessment 1976/77 to 1980/81 by understating profits chargeable to tax. The tax found to have been undercharged was \$112,949 and additional penalty tax assessments were raised on the Taxpayer under section 82A in a total amount of \$92,400.
4. When the Taxpayer attended an interview at the Inland Revenue Department on 19 November 1985 during which the quantum of profits understated for the years of assessment 1976/77 to 1980/81 was agreed, the investigation officers also asked the Taxpayer to review the accounts of the business for the years of assessment 1981/82 to 1984/85 and told him that a separate investigation would be conducted in the future.
5. By a letter dated 11 December 1986 the Taxpayer confirmed that no adjustment was required with regard to the accounts submitted for the years of assessment 1980/81 to 1984/85 after a review had been taken.
6. The profits tax returns in respect of the business filed by the Taxpayer for the years of assessment 1983/84 to 1989/90 were prepared by an accountant firm. The following is a summary of the information extracted from the returns:

<u>Year of Assessment</u>	<u>Date of Filing Return</u>	<u>Basis Period</u>	<u>Returned Profits/(Loss)</u> \$
1983/84	17-7-1984	year ended 31-12-1983	187,599
1984/85	28-6-1985	year ended 31-12-1984	178,241
1985/86	15-9-1986	year ended 31-12-1985	(88,530)
1986/87	31-7-1987	year ended 31-12-1986	102,867

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1987/88	30-8-1988	year ended 31-12-1987	136,173
1988/89	16-5-1989	year ended 31-12-1988	90,680
1989/90	28-6-1990	1-1-1989 to 31-7-1989	184,984

7. On divers dates, the assessor raised the following profits tax assessments on the Taxpayer in respect of the business per the returns submitted with minor technical adjustments, where required:

<u>Year of Assessment</u>	<u>Returned Profits/(Loss)</u> \$	<u>Profits Assessed</u> \$
1983/84	187,599	206,609
1984/85	178,241	178,241
1985/86	(88,530)	(88,530)
1986/87	102,867	102,867
1987/88	136,173	136,173
1988/89	90,680	90,680
1989/90	184,984	184,984

8. In December 1989, the Inland Revenue Department carried out a second investigation into the affairs of the Taxpayer.

9. By letters dated 19 February 1990 and 23 February 1990, the investigation officer invited the Taxpayer to attend an interview to be held in the Inland Revenue Department within a period of 10 days. No reply, however, was received from the Taxpayer. It was later found out that the Taxpayer and his family had gone to Country A during the period from 22 February 1990 to 17 March 1990.

10. On 12 March 1990, the assessor raised in respect of the business an additional profits tax assessment for the year of assessment 1983/84 in the amount of \$400,000. The Taxpayer lodged an objection against this assessment.

11. On 30 March 1990 the Taxpayer, accompanied by his accountant, Mr Y, was interviewed by two investigation officers of the Inland Revenue Department. During that interview, the investigation officer told the Taxpayer that the Department was undertaking a second investigation of his tax affairs and explained to him the penal provisions of the Inland Revenue Ordinance. The Taxpayer confirmed that the profits tax returns of the business for the years of assessment 1983/84 to 1988/89 were signed by him and that he had not understated the profits of his business. The Taxpayer also told the investigation officers that the books of the business were kept by a Mr L who had been working for the business for many years. Mr Y was the Taxpayer's part-time accountant and was responsible for compiling the annual financial statement. The Taxpayer confirmed that he had no plan for emigration to another country and he did not have any property in Country A. On 2 April 1990, by a telephone call, the Taxpayer corrected this information and told the investigation

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officer that he and his family members were landed emigrants of Country A since 1988. He had bought a house in a city of Country A for about \$150,000 in currency A.

12. In reply to enquiries from the Inland Revenue Department the Taxpayer by letter dated 29 June 1990 provided to the Inland Revenue Department a schedule of quoted share transactions and a list of the Taxpayer's assets and liabilities as at 31 December 1989.

13. After extensive enquiries and analysis of bank accounts, and from other relevant information available, the investigation officer compiled an assets betterment statement for the Taxpayer covering the period from 1 January 1983 to 31 December 1988 showing a discrepancy of \$7,243,371. In the assets betterment statement, the net profits on sale of quoted shares of \$744,523 computed from the shares schedules submitted by the Taxpayer as mentioned in the preceding fact 13 had been allowed as a deduction. The assets betterment statement was issued to the Taxpayer on 21 March 1991 for comment and agreement.

14. Also on 21 March 1991 the investigation officer, based on the assets betterment statement, raised additional profits tax assessments for the years of assessment 1984/85 and 1986/87 to 1988/89 and an original profits tax assessment for the year of assessment 1985/86 on the business with tax payable on or before 28 March 1991 as follows:

<u>Year of Assessment</u>	<u>*Assessable Profits/ Additional Assessable Profits</u> \$	<u>Tax Payable</u> \$
1984/85	1,368,674	406,155
1985/86	1,368,674*	230,782
1986/87	1,368,674	232,674
1987/88	1,368,674	225,831
1988/89	1,368,674	212,144

15. By letters dated 17 April 1991 and 22 April 1991, the Taxpayer lodged an objection against these assessments.

16. On 27 March 1991 the Taxpayer, accompanied by his accountant Mr Y, was interviewed by two investigation officers. Contents of the assets betterment statement and in particular, how the quantum of investment in quoted shares was arrived at were explained to the Taxpayer. He was also informed that if he defaulted in paying the tax, a Court Stop Order to prevent him from leaving Hong Kong would be applied for. The Taxpayer and Mr Y attended another interview with two investigation officers on 28 March 1991 during which the Taxpayer indicated that he intended to settle the tax by instalments. Various items of the assets betterment statement were also discussed.

17. Also on 28 March 1991, a Court Stop Order was issued to prevent the Taxpayer from leaving Hong Kong without paying the tax. On 2 April 1991, the Taxpayer applied to

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the Inland Revenue Department to settle part of the tax by payment and the remaining part by the provision of a bank guarantee. It was accepted by the Inland Revenue Department and the Taxpayer was released from the Court Stop Order on 2 April 1991.

18. By a letter dated 17 April 1991, the Taxpayer made representations to the assets betterment statement. Further representations were made by the Taxpayer in a letter dated 20 July 1991.

19. On 13 November 1991 the Taxpayer, accompanied by his accountant Mr Y, was again interviewed by the investigation officers. During this interview, the investigation officers produced a revised assets betterment statement showing a revised discrepancy of \$7,035,275 for the period from 1 January 1983 to 31 December 1988. It was also proposed that the case be settled on the basis of this revised assets betterment statement for the years of assessment 1983/84 to 1988/89 and for the year of assessment 1989/90, the assessable profits be recomputed by applying a gross profit rate of 8.5%.

20. On 15 November 1991, the Taxpayer with his accountant, Mr Y, attended a further interview with two investigation officers during which the Taxpayer indicated his acceptance of the revised assets betterment statement covering the period from 1 January 1983 to 31 December 1988 showing a total revised discrepancy of \$7,035,275 and signed the revised assets betterment statement. He also proposed that the additional assessable profits for the year of assessment 1989/90 be agreed at \$358,925, computed by applying a gross profit rate of 8%.

21. On 11 December 1991, based on the revised assets betterment statement and the proposal from the Taxpayer, revised additional profits tax assessments for the years of assessment 1983/84, 1984/85, 1986/87 to 1988/89, revised profits tax assessment for the year of assessment 1985/86 and additional profits tax assessment for the year if assessment 1989/90 were issued to the Taxpayer in the following manner:

<u>Year of Assessment</u>	<u>Revised Additional Assessable Profits/ *Revised Assessable Profits/ #Additional Assessable Profits</u> \$
1983/84	1,085,031
1984/85	1,113,400
1985/86	1,291,641*
1986/87	1,188,774
1987/88	1,155,468
1988/89	1,200,961
1989/90	358,925#

22. The following is a comparative table of the assessable profits/(loss) before and after investigation and the amount of tax undercharged in consequence of the submitted incorrect profits tax returns of the business:

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<u>Year of Assessment</u>	Profits/(Loss) Before <u>Investigation</u> \$	Profits After <u>Investigatio</u> <u>n</u> \$	Profits <u>Understated</u> \$	Loss <u>Over- claimed</u> \$	Tax <u>Undercharge</u> <u>d</u> \$
1983/84	206,609	1,291,640	1,085,031	-	162,754
1984/85	178,241	1,291,641	1,113,400	-	190,546
1985/86	(88,530)	1,291,641	1,291,641	88,530	237,759
1986/87	102,867	1,291,641	1,188,774	-	202,091
1987/88	136,173	1,291,641	1,155,468	-	190,652
1988/89	90,680	1,291,641	1,200,961	-	186,148
1989/90	184,984	543,909	358,925	-	53,838
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	811,024	8,293,754	7,394,200	88,530	1,223,788
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23. The Commissioner of Inland Revenue was of the opinion that the Taxpayer had, without reasonable excuse, made incorrect profits tax returns in respect of the business for the years of assessment 1983/84 to 1989/90 inclusive. A notice under section 82A(4) of the Inland Revenue Ordinance was issued to the Taxpayer on 31 January 1992 informing him of the Commissioner's intention to assess additional tax under section 82A of the Inland Revenue Ordinance.

24. By a letter dated 18 February 1992, the Taxpayer submitted written representations to the Commissioner of Inland Revenue.

25. The Commissioner of Inland Revenue, having considered and taken into account the Taxpayer's representations, issued on 9 March 1992 Notices of Assessment and Demand for Additional Tax under section 82A for the years of assessment 1983/84 to 1989/90 to the Taxpayer in the following amounts:

<u>Year of Assessment</u>	Tax <u>Undercharged</u> \$	Section 82A <u>Additional Tax</u> \$	Percentum of Tax <u>Undercharged</u>
1983/84	162,754	249,000	153%
1984/85	190,546	291,500	153%
1985/86	237,759	351,100	148%
1986/87	202,091	283,000	140%
1987/88	190,652	253,300	133%
1988/89	186,148	234,900	126%
1989/90	<u>53,838</u>	<u>67,400</u>	125%

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1,223,788

=====

1,730,200

=====

141%

26. The Taxpayer gave notice of appeal against the section 82A assessments to additional tax.

At the hearing of the appeal the Taxpayer appeared in person. He said that he was dissatisfied with the estimated tax assessments which had been raised on him and that he had no intention to evade tax. He said that most of the information which the Inland Revenue Department had was supplied by him on his own initiative. He said that this demonstrated that he did not intend to evade tax.

He said that the second investigation was really just a continuation of the first investigation. He complained about the fact that the Inland Revenue Department had stopped his leaving Hong Kong in March 1991 because it had damaged his business in China and hurt his credibility.

He said that the investigation into his affairs had affected his health. He said that the increase in his wealth was because he had accumulated great gains on the stock market before the crash in 1987. He also said that he had been able to increase his assets because of the open door policy implemented in China which allowed him to find a market for what had previously been 'stagnant goods'.

The Taxpayer said that his education level was very low and he had problems with his accounting staff. He said that the stagnant goods sold to China which had previously been written off were not recorded in the accounts by his accounting personnel. He then said that he had made some money in betting and on the Mark Six lottery.

The representative for the Commissioner submitted that this was a serious case. She pointed out that the Taxpayer had been in business since 1976 and that prior to the present case the Taxpayer had submitted incorrect profits tax returns for the years of assessment 1976/77 to 1980/81. A second investigation had discovered that the Taxpayer had again submitted incorrect profits tax returns for the years of assessment 1983/84 to 1989/90. She pointed out that the understatement of profits was very large and that the Taxpayer had been operating a multi-million dollar business. She pointed out that annual sales ranged from \$26,000,000 to \$33,000,000 during the years of assessment 1983/84 to 1988/89 and reached \$15,000,000 in the last seven trading months in the year of assessment 1989/90. She drew our attention to the fact that there was a main shop and a branch shop and that over 20 staff were employed. She also pointed out that the Taxpayer had set up a limited company to carry on the same line of business.

It is difficult to have any great sympathy for the Taxpayer in this case because he is the author of his own misfortune. The conduct of the Taxpayer is such that it comes very close to evasion of tax which would be a criminal matter.

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The Taxpayer has sought to place the blame upon his accounting staff but this is wholly unacceptable. A person who carries on business in Hong Kong is responsible to keep true and correct accounts of his business and to file true and correct tax returns. This the Taxpayer has failed to do and can blame no one other than himself. He is not an unsophisticated shopkeeper or businessman. He in fact operated a sophisticated business with two shops and a large number of staff. His turnover was substantial. He claims to have made profits on the stock market. This claim has been accepted by the assessor who has allowed in full the profits which he claims to have made from his stock exchange transactions. The assessor could be no more generous than to allow a deduction from the assets betterment statement of the sums claimed by the Taxpayer.

In the circumstances of this case we find that the penalties imposed by the Commissioner are not excessive and confirm the same. We dismiss this appeal.