

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D33/99

Penalty Tax – background of the taxpayer – cooperation with the assessor – uniform rate of penalty tax assessment.

Panel: Anna Chow Suk Han (chairman), Robin M Bridge and Albert Yau Kai Cheong.

Date of hearing: 7 May 1999.

Date of decision: 8 July 1999.

The taxpayer is a widow and the administratrix of the estate of Mr B, deceased died on 23 October 1992, ('Deceased') formerly trading as Company C. The Deceased was the sole proprietor of the business which commenced on 1 May 1985 as a sub-contractor of foundation engineering work for construction sites. The taxpayer had not taken part in the running of the business.

The assessor commenced an investigation into the tax affairs of the Deceased. The taxpayer did not appeal to the assessments revised by the Commissioner for the years of assessment 1998/98 to 1991/92. The assessments under objection for the years of assessment 1988/89 to 1991/92 were revised accordingly. The Commissioner demanded for additional tax under section 82A of the IRO. The taxpayer appealed to the assessments to additional tax.

It was the taxpayer's cause that it was not possible for the taxpayer to find out and present all relevant documents and details regarding whether the Deceased's tax return were correct or not. Moreover the taxpayer contended that the surcharges are excessive.

Held:

- (1) The taxpayer having failed to seek leave to appeal out of time under section 66(1A) of the IRO, it is not open to the taxpayer to submit that she was not properly charged to profits tax. Accordingly, in this appeal the Board only deal with the quantum and not the liability of the assessment.
- (2) The Board found that there were mitigating factors on the background of the taxpayer. The Board found sympathy for the taxpayer for having to look after her sons, both with terminal illness, the taxpayer did not take part in the Deceased's business nor had knowledge of his affairs. Her task was made more difficult by the lack of records and books of the business. The investigation which lasted for a number of years must be a difficult and painful experience for the taxpayer.

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- (3) The Board also found another mitigating factor on the cooperation of the taxpayer with the assessor which warrant a reduction of the penalty charged. By appointing tax representatives and having replied to the assessor's enquiries without undue delay, the Board found that the taxpayer had been cooperative with the assessor as best as he could under the circumstances.
- (4) A uniform rate was adopted because the Board viewed that the tragic background applied to each year of assessment.

Appeal allowed in part.

Tang Yiu Fai for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

The appeal

1. This is an appeal by Ms A ('the Taxpayer') the widow and the administratrix of the estate of Mr B, deceased ('the Deceased') against the additional tax assessments imposed upon her in her capacity as the administratrix of the estate of the Deceased formerly trading as Company C, under section 82A of the Inland Revenue Ordinance ('the IRO') for the years of assessment 1988/89 to 1991/92.

The agreed facts

2. The additional tax assessments were penalty assessments imposed for the incorrect profits tax returns made by the Deceased in respect of Company C ('the Business') for the years of assessment 1988/89 to 1991/92.

3. At all the relevant times, the Deceased was the sole proprietor of the Business which commenced on 1 May 1985. It was a sub-contractor of foundation engineering work for construction sites. On 1 October 1992, the Business was taken over by Company C which was owned by the Taxpayer and the Deceased's sister, Ms D.

4. On divers dates, the assessor raised on the Deceased the following profits tax assessments in respect of the Business for the years of assessment 1988/89 to 1990/91 in accordance with the returns submitted by the Deceased, with minor technical adjustments for the year of assessment 1988/89.

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Year of Assessment	Basis Period	Assessable Profits \$
1988/89	year ended 31 March 1989	94,734
1989/90	year ended 31 March 1990	282,833
1990/91	year ended 31 March 1991	408,635

The Deceased did not object to the above assessments but elected to be assessed under personal assessment for the years of assessment 1988/89 and 1989/90.

5. The profits tax return in respect of the Business for the year of assessment 1991/92 filed by the Deceased on 13 August 1992 showed the following particulars:

Year of Assessment	Basis Period	Assessable Profits \$
1991/92	year ended 31 March 1992	109,610

6. The assessor commenced an investigation into the tax affairs of the Deceased. The Taxpayer appointed Messrs S H Chan & Co ('the First Representatives') and a consultancy company ('the Second Representatives') as her joint tax representatives.

7. By a letter dated 20 July 1994, the First Representatives stated that the Taxpayer was not directly involved in the Business and was therefore not familiar with its financial situation. The Taxpayer claimed that the accounting books and records of the Business had been placed with the previous accountant of the Business, who had already migrated to foreign country in 1992 and that they had never been in her possession.

8. On 10 August 1994, the Taxpayer attended an interview with the assessors. During the interview, the Taxpayer stated that she had no idea about the affairs of the Business and the source of income of the Deceased.

9. On 24 August 1994, the assessor raised on the Taxpayer, in her capacity as the personal representative of the estate of the Deceased, the following profits tax assessments in respect of the Business:

Year of Assessment	Assessable Profits \$
1988/89	700,000 (Additional)
1989/90	600,000 (Additional)
1990/91	600,000 (Additional)
1991/92	909,610

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10. By a letter dated 22 September 1994, the Taxpayer, through the Second Representatives, lodged objections against the above assessments on the ground of excessiveness and claimed that the Deceased was the shareholder of a number of property investment companies from which he had derived profits of over \$1,000,000.

11. By a letter dated 24 August 1994, the assessor requested the Taxpayer to submit the accounting records and information, including the assets and liabilities of the Deceased and the Taxpayer covering the period from 1 April 1988 to 31 March 1993. A partial reply dated 8 January 1995 was received from the Second Representatives.

12. By a letter dated 9 November 1995, the assessor requested the Taxpayer to submit a full reply to the assessor's letter of 24 August 1994. By a letter dated 6 December 1995, the Second Representatives informed that the Taxpayer could not supply any further information.

13. On 18 November 1996, the assessor requested the Taxpayer to explain certain deposits and withdrawals from the bank accounts of the Deceased. By a letter dated 23 December 1996, the First Representatives replied that the Taxpayer was unable to locate the relevant information as the accounts were managed by the Deceased.

14. On 12 May 1997, the assessor requested the Taxpayer to explain the nature of certain withdrawals from her personal bank accounts. The Taxpayer attended an interview on 9 July 1997 and informed the assessor that the withdrawals were repayment of loans borrowed from the brothers of the Deceased who resided in Country E. Despite repeated requests, no documentary evidence was produced by the Taxpayer to substantiate the alleged loans.

15. After making extensive enquiries and analyses of the bank accounts, the assessor found that the Deceased's assets in Hong Kong had increased substantially during the period from 1 April 1988 to 31 March 1992.

16. By a letter dated 19 December 1997, the chief assessor sent to the Taxpayer an assets betterment statement ('ABS') compiled from the bank statements and bank passbooks of the Deceased and the Taxpayer and other relevant information covering the period from 1 April 1988 to 31 March 1992. The ABS revealed the following discrepancy:

Year of Assessment	Betterment Profits	Profits Returned/ Assessed	Discrepancy
	\$	\$	\$
1988/89	462,429	94,734	367,695
1989/90	3,087,717	282,833	2,804,884
1990/91	1,850,695	408,635	1,442,060
1991/92	<u>2,790,817</u>	<u>109,610</u>	<u>2,681,207</u>
	<u><u>8,191,658</u></u>	<u><u>895,812</u></u>	<u><u>7,295,846</u></u>

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The Taxpayer was asked to consider the correctness of the statement and to indicate the items and quantum in dispute.

17. By letters dated 3 January 1998 and 13 February 1998, the Taxpayer, through the Second Representatives, informed the assessor that she could not confirm the correctness of the information contained in the ABS except for the cost of the landed properties of \$2,000,000 and \$3,300,000 as at 31 March 1991 and 31 March 1992 respectively and the outward remittances of \$854,590 and \$992,233 during the year ended 31 March 1991 and 31 March 1992 respectively.

18. On 2 April 1998, the assessor sent to the Taxpayer a letter proposing to revise the assessments under objection on the basis of the betterment profits or discrepancy shown in the ABS for the relevant years of assessment as follows:

Year of Assessment	Betterment Profits	Proposed Revised Assessable Profits
	\$	\$
1988/89	462,429	367,695 (Additional)
1989/90	3,087,717	2,804,884 (Additional)
1990/91	1,850,695	1,442,060 (Additional)
1991/92	2,790,817	2,790,817

19. The Taxpayer has failed to respond to the assessor's offer for settlement. On 11 May 1998, the Second Representatives informed the assessor over the phone that the Taxpayer was not prepared to give any response to the assessor's letter dated 2 April 1998.

20. By a notice dated 15 July 1998, the Commissioner informed that Taxpayer that the assessments be revised in accordance to the betterment profits or discrepancy shown in the ABS.

21. The Taxpayer did not appeal to the Board of Review under section 66(1)(a) of the IRO. The assessments under objection for the years of assessment 1988/89 to 1991/92 were revised accordingly.

22. A detailed computation of the profits understated and the tax undercharged is as follows:

Year of Assessment	Assessable Profits Before Investigation	Assessable Profits After Investigation	Profits Understated	Tax Undercharged
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	\$	\$	\$	\$
1988/89	94,734	462,429	367,695	71,328
1989/90	282,833	3,089,717	2,804,884	421,299
1990/91	408,635	1,850,695	1,442,060	216,309
1991/92	<u>109,610</u>	<u>2,790,817</u>	<u>2,681,207</u>	<u>402,181</u>
	<u><u>895,812</u></u>	<u><u>8,191,658</u></u>	<u><u>7,295,846</u></u>	<u><u>1,111,117</u></u>

The percentage of profits understated to the total profits assessed after investigation for the years of assessment 1988/89 to 1991/92 is 89%.

23. On 19 October 1998, the Commissioner gave notice to the Taxpayer of his intention to assess additional tax under section 82A of the IRO in respect of the incorrect tax returns made by the Deceased for the years of assessment 1988/89 to 1991/92.

24. By a letter dated 9 November 1998, the Taxpayer submitted, through the Second Representatives, written representations to the Commissioner. Having considered and taken into account the Taxpayer's representations, the Commissioner issued on 30 November 1998 the following notices of assessment and demand for additional tax under section 82A of the IRO:

Year of Assessment	Tax Undercharged \$	Section 82A Additional Tax \$	Additional Tax as Percentage of Tax Undercharged
1988/89	71,328	28,000	39%
1989/90	421,299	307,000	73%
1990/91	216,309	132,000	61%
1991/92	<u>402,181</u>	<u>202,000</u>	<u>50%</u>
	<u><u>1,111,117</u></u>	<u><u>669,000</u></u>	<u>60%</u>

25. By a letter dated 14 December 1998, the Taxpayer gave notice of appeal to the Board of Review against the above assessments to additional tax.

Our findings

26. The grounds of appeal submitted by the Second Representatives on behalf of the Taxpayer are as follows:

- (1) Since Mr B (Deceased) passed away six years ago, it is indeed not possible for our client, Ms A, to find out and present all the relevant documents and details regarding whether the Deceased's tax returns were correct or not.

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- (2) Mr B was the shareholder of 13 companies, while on ABS worked out by the assessor, only 4 of them were listed and calculated. Our client reiterated that such calculations are by no means fair and proper.
- (3) In view of the queries and doubts stated above, we are representing our client, Ms A, requesting the Board to reconsider the case, and thus waive and write off the following penalty, namely, the additional charges:

Year of Assessment	\$	
1988/89	28,000	(representing 240% of the additional assessment)
1989/90	307,000	(representing 82% of the additional assessment)
1990/91	132,000	(representing 77% of the additional assessment)
1991/92	202,000	(representing 63% of the additional assessment)

It is arbitrary and unfair to simply conclude that the Deceased was totally tax evasive while it would never be able for him to defend for himself. In any sense, the above surcharges are too much and unacceptable for our client.'

27. Under section 70 of the IRO, the assessments made on 15 July 1998 became final and conclusive. The Taxpayer having failed to seek leave to appeal out of time under section 66(1A) of the IRO in D32/99, it is not open to the Taxpayer to submit that she was not properly charged to profits tax. Accordingly, in this appeal we only deal with the quantum and not the liability of the assessment. We will only consider whether the amounts of additional tax in question, are excessive having regard to the circumstances of this case.

28. In considering the merits of this appeal, we take into account the following facts.

29. The Deceased was the sole proprietor of the Business which carried on the business of a sub-contractor of foundation engineering work for construction sites since 1 May 1985. The Taxpayer had not taken part in the running of the Business. We were told that the Deceased did not employ any clerical staff and the accounting books and records of the Business were kept by the accounting firm. The Deceased died on 23 October 1992.

30. As from the beginning of the investigation by the assessor in 1994, the First Representatives and the Second Representatives were appointed as the Taxpayer's tax representatives.

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31. At the hearing, the Taxpayer appeared in person and chose not to give evidence. Ms D was called as a witness and gave evidence on her behalf. We were told that the Taxpayer does not understand English and it was Ms D who had taken care of the case and the one who contacted the lawyers and the accountants. We observe from the statements of facts that Ms D also accompanied the Taxpayer in her interviews with the assessors. It is apparent that the Taxpayer had to rely heavily on Ms D's assistance in the investigation.

32. It was explained to us that the Taxpayer did not know anything about the Deceased's dealings or business as the Taxpayer's time was totally spent on looking after her two sons who were suffering from leukaemia. One of her sons died in 1986 at the age of 7 after a short period of illness and the other one died in 1992 at the age of 11 after a prolonged illness of five years. The Deceased also died in 1992 at the age of 39. He had an operation in 1991 and was hospitalized frequently prior to his death. For a period before he died, he only attended his business half day.

33. Apart from not having any personal knowledge of the Deceased's affairs, the Taxpayer did not have the books and accounts of the Business to assist her in the assessor's investigation. Ms D explained that the Deceased moved his office in February 1992 and could have left the company's old documents behind. She was not advised by their solicitors or tax representatives to locate the company's accountants who migrated to foreign country, through Hong Kong Society of Accountants, nor through international telephone directory enquiry.

34. We feel sympathy for the Taxpayer for having to deal with the investigation which must have been an uneasy task. Having to look after her sons, both with terminal illness, the Taxpayer did not take part in the Deceased's Business nor had knowledge of his affairs. Her task was made more difficult by the lack of records and books of the Business. The investigation which lasted for a number of years must be a difficult and painful experience for the Taxpayer.

35. Notwithstanding that the Taxpayer had been unable to agree to the ABS prepared by the assessor, by appointing tax representatives and having replied to the assessor's enquiries without undue delay, we accept that she had been cooperative with the assessor as best as she could under the circumstances.

36. Mr Tang for the Respondent (the CIR) submitted that the general rule established in the Board of Review cases is that the starting point for assessing penalty should be 100% of the tax undercharged. In determining the quantum of penalty in the present case, the Respondent had taken into account the facts that the penalty would fall on the administratrix of the estate and it would be difficult for the widow to supply information and that the quantum of profits was quantified by a direct approach. The additional tax now assessed on the Taxpayer is 60% of the total tax undercharged.

37. Mr Tang agreed that they were unaware of the tragic background of the Taxpayer and that this factor had not been taken into account when the assessment was made.

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38. On the facts before us, we are of the view that that there are mitigating factors such as the Taxpayer's background and her co-operation with the assessor which warrant a reduction of the penalty charged. We decide to reduce the amounts of additional tax for the years of assessment 1988/89 to 1991/92, as referred to in paragraph 24 above each by 17%, and the amounts of additional tax shall be reduced to a total of \$555,270. We adopt a uniform rate because we view that the tragic background applies to each year of assessment.