Case No. D34/99

Penalty Tax – incorrect salaries tax return – sections 11D(a), 51, 68(4), 68(8)(a) 82A and 82B of the Inland Revenue Ordinance.

Panel: Mathew Ho Chi Ming (chairman), Lester Kwok Chi Hang and Andrew Wang Wei Hung.

Date of hearing: 26 February 1999.
Date of decision: 16 July 1999.

The taxpayer and his wife were the shareholders and sole directors of Company X at all material times.

The Inland Revenue Department alleged that 2 special bonuses to the taxpayer as director of Company X, rental value and director's expense allowance were omitted or understated in 3 tax returns of the taxpayer.

Due to the haphazard manner of keeping of the books of the businesses of the taxpayer, the special bonuses were resolved to be given to the taxpayer by Company X after the accounts have been finalised and audited. The special bonuses had not come into existence at the time of the relevant tax returns.

The taxpayer's case was that through the tax filings of Company X, which is controlled and signed by the taxpayer, the taxpayer had already disclosed to the Inland Revenue Department the special bonuses, the rental value and the director's expense allowance. The employer's returns, the audited accounts and all information provided by Company X to the Inland Revenue Department were signed by the taxpayer. Further, the taxpayer was very involved in his business and he left matters relating to accounting to the account manage whom he employed.

Held:

(1) A taxpayer declares in his tax return $X income. Subsequently, this employer then decides to give him a bonus of $Y which is taxable. This does not render his tax return incorrect as at the time of filing his tax return. The taxpayer simply did not know that he will have an extra $Y income accruing to him. Even if the taxpayer were in the position to control his employer, the legal reality is that the bonus was not his until the employer decided to award the bonus to him.

(2) There is no statutory obligation on a taxpayer to file a supplemental return or inform the Inland Revenue Department of subsequent taxable income for a tax year which has come to his knowledge after he has filed his tax return for that tax year.

(3) The special bonuses have been received if they have been made available or have been dealt with. The special bonuses have been made available to the taxpayer or has been dealt with on his behalf at the time when the special bonus board resolutions were passed and when the director's current account in Company X's balance sheet was adjusted. Given that the taxpayer is the controlling mind of Company X, once the special bonuses resolutions were passed, the section 11D(a) proviso applied and the spectral bonuses became declarable income for the tax years in which the resolutions were passed.

(4) The taxpayer is allowed to adduce evidence to show that the tax returns were not incorrect.

(5) The taxpayer cannot rely on Company X's tax filings an replies to Inland Revenue Department queries to satisfy his personal duty to disclose his own personal income which are required under the provisions of the Inland Revenue Ordinance. The company and the taxpayer are separate legal entities. It is not up to the Inland Revenue Department to try and match employer/payer and employee/payee tax filings to assess the taxable income of the employee/payee. The individual payee's duties in making the tax filings are clear and unambiguous.

(6) The taxpayer must be aware that it is his duty to ensure correct tax returns are filed within the time permitted. When he fails in his duty, he cannot excuse himself by blaming it on the incompetence of staff. To attempt to blame the accounting manager and the auditor points to the irresponsible attitude of the taxpayer.

Appeal partly allowed.

Cases referred to:

Dodge Trading Ltd v CIR (1989) 2 HKTC 597
D36/88, IRBRD, vol 3, 354
D42/88, IRBRD, vol 3, 395
D46/89, IRBRD, vol 4, 502
D34/88, IRBRD, vol 3, 336
D43/89, IRBRD, vol 4, 484

Tsoi Chi Yi for the Commissioner of Inland Revenue.

Tai Sheung Yan of Messrs Starkings International Limited for the taxpayer.

Decision:

Nature of appeal

1. The Taxpayer is appealing against the liability and quantum of additional tax assessed upon him by way of penalty under section 82A of the Inland Revenue Ordinance ('the IRO') for making incorrect salaries tax return for the year of assessment 1991/92 and tax returns for individuals for the years of assessment 1993/94 and 1994/95.

2. No oral testimony was given by the Taxpayer in this hearing in which submissions were made and documents were handed to the Board by the Taxpayer's representative both prior to and at the time of the hearing.

Undisputed facts

3. The Taxpayer does not dispute the statement of facts prepared by the Inland Revenue Department ('IRD') except paragraph 20 thereof. The Taxpayer queried the relevance of inclusion (in the IRD's statement of facts) of facts relating to previous tax investigations on the Taxpayer. Also no admission is made by the Taxpayer in respect of the appendices annexed to the IRD's statement of facts where these appendices were created or written by the IRD. With these caveats, we now set out those parts of the statement of facts which relate to this appeal (with minor modifications and editing to the various tables). These undisputed facts are part of our findings of fact in this appeal.

4. During the relevant years of assessment, the Taxpayer was the shareholder and director of a group of private companies. The flagship of the group was Company X. ('Company') of which the Taxpayer and his wife are the shareholders and sole directors at all material times.

5. On divers dates, the Taxpayer submitted his duly signed salaries tax returns for the years of assessment 1991/92 and 1992/93 and tax returns for individuals for the years of assessment 1993/94 and 1994/95. These tax returns showed the following employment income:

	Date of Tax Return	Year of Assessment	Employer	Income	Quarters Provided
				$	
a.	2-5-1992	1991/92	Company	4,536,000	blank
b.	2-6-1993	#1992/93	Company	5,500,000	blank
c.	10-61994	1993/94	Company	6,600,000	
			another company	25,000	
				6,625,000	blank
d.	undated	1994/95	Company	8,840,000	
			another company	162,500	
				9,002,500	blank

 # Not a tax year under appeal but relevant for this appeal.

6. The Company filed employer's returns in respect of the Taxpayer for the relevant years under appeal. These employer's returns were signed by the Taxpayer as director of the Company and showed the following particulars:

	Employer Return Date	Year of Assessment	Description	Total Remuneration	Quarters Provided
				$	
a.	29-4-1992	1991/92	Directors fees	4,536,000	No
b.	11-5-1993	#1992/93	Directors fees	3,088,800	
			Bonus	2,411,200	
				5,500,000	Blank
c.	30-4-1994	1993/94	Salary/Wages	3,600,000	
			Bonus	3,000,000	
				6,600,000	*Yes
d.	7-9-1994	1993/94	Bonus	10,000,000	*Yes
e.	15-5-1995	1994/95	Salary/Wages	3,840,000	
			Bonus	5,000,000	
				8,840,000	*Yes

 # Not a tax year under appeal but relevant for this appeal.

** Particulars of the quarters provided in the years of assessment 1993/94 and 1994/95 were not supplied.*

7. The following salaries tax assessments were raised on the Taxpayer based on the tax returns filed by the Taxpayer:

Year of Assessment	Date of Issue	Assessable Income
		$
1991/92	8-9-1992	* 4,536,000
#1992/93	8-9-1992	* 5,500,000
1993/94	4-1-1995	** 10,025,000
1994/95	24-10-1995	* 9,002,500

\# *Not a tax year under appeal but relevant for this appeal.*

* *As declared by the Taxpayer in his tax returns set out in paragraph 5 above.*

** *This assessment being made in the circumstances set out in paragraph 26 below.*

On 16 June 1997, an additional salaries tax assessment for the year of assessment 1994/95 was raised on the Taxpayer in respect of the rental value omitted. The Taxpayer did not object to the above salaries tax assessments.

8. The Company submitted duly signed profits tax returns for the years of assessment 1991/92, 1993/94 and 1994/95. These were signed by the Taxpayer as director of the Company. The accompanying profit and loss accounts showed, inter alia, the following expenses:

Year of Assessment	Basis Period (year ended)	Nature of Expenses	Amount
			$
1991/92	31-3-1992	Directors' remuneration	26,048,000
1993/94	31-3-1994	Directors' remuneration	18,800,000
1994/95	31-3-1995	Directors' remuneration	990,453

9. In the supporting schedule accompanying the profits tax return for the year of assessment 1994/95, a breakdown of the directors' quarters expenses was provided as follows:

	$
Rates	29,403
Building management fee	52,560
Telephone	7,489

Electricity, water and gas	13,178
Furniture and fixtures	5,429
Repairs and maintenance	8,800
Overseas travelling	3,451
Entertainment	8,543
Directors' expense allowances	860,000
Clothing allowance	1,600
	$990,453

10. In October 1995, the IRD commenced investigations into the tax affairs of the Taxpayer. There were various interviews with the Taxpayer, his accounting manager and his then tax representatives of the Company. The IRD also visited the Company's offices and inspected the Company's records. The investigations covered 3 other financial years and other matters not directly the subject matter of this appeal save as to the consideration of whether the quantum of additional tax was excessive in the light of these not directly relevant investigations or other matters.

11. After the investigations and negotiations between the IRD and the Taxpayer, on 30 June 1998, revised additional/additional salaries tax assessments and original profits tax assessment were issued to the Taxpayer as follows:

Year of Assessment	**Assessment**	**Additional Assessable Income**	**Revised Total Assessable Income**
		$	$
1991/92	Revised Additional	20,414,000	24,950,000
# 1992/93	Additional	414,000	5,914,000
1993/94	Additional	7,014,000	17,039,000
1994/95	Additional	860,000	10,746,500
# 1996/97	Additional	8,000,000	20,162,500

\# *Not a tax year under appeal but relevant for this appeal.*

12. The following is a comparative table of the taxpayer's assessable income and profits before and after investigation and the amount of tax undercharged in consequence of the incorrect salaries tax returns and tax return for individuals submitted by the Taxpayer:

Year of Assessment	**Initial Assessment**	**New Assessment**	**Income Understated**	**Tax Undercharged**
	$	$	$	$
1991/92	4,536,000	24,950,000	20,414,000	3,062,100
# 1992/93	5,500,000	5,914,000	414,000	62,100

1993/94	10,025,000	17,039,000	7,014,000	1,052,100
1994/95	* 9,886,500	* 10,746,500	860,000	129,000
# 1996/97	12,162,500	20,162,500	8,000,000	1,200,000

 # Not a tax year under appeal but relevant for this appeal.

** These figures may be incorrect in IRD's statement of facts. The correct initial assessment should be $9,002,500. But the quantum of income understated and tax undercharge remains unaffected by these incorrect figures.*

After taking into account the incomes understated for the 3 other tax years (not under appeal), the average percentage of income understated to total income assessed after investigation was 44.45%.

13. On 5 August 1998, the IRD issued to the Taxpayer a notice under section 82A(4) of the IRO informing the Taxpayer of the IRD's intention of imposing additional tax on the Taxpayer due to the incorrect tax returns. The notice is set out herein in full:

> *'I am of the opinion that you have, without reasonable excuse, made incorrect tax returns for the years of assessment mentioned below by understating income chargeable to tax to the extent of $37,186,000.*
>
> *The amount of tax which has been undercharged in consequence of the incorrect returns, or which would have been so undercharged if the returns had been accepted as correct is as follows:*

Year of Assessment	**Amount of Tax**
1989/90	18,000
1990/91	54,600
1991/92	3,062,100
1992/93	62,100
1993/94	1,052,100
1994/95	129,000
1996/97	1,200,000
	5,577,900 '

14. Having considered and taken into account the Taxpayer's representations, the Commissioner decided to impose no additional tax in respect of the incorrect tax return for the year of assessment 1996/97 but issued on 9 October 1998 notices of assessment and demand for additional tax under section 82A of the IRO to the Taxpayer in respect of the incorrect tax returns as follows:

Year of Assessment	Tax Undercharged	Section 82A Additional Tax	Additional Tax as Percentage of Tax Undercharged
	$	$	$
# 1989/90	18,000	13,000	72%
# 1990/91	54,600	39,000	71%
1991/92	3,062,100	1,725,000	56%
#1992/93	62,100	47,000	75%
1993/94	1,052,100	538,000	51%
1994/95	129,000	63,000	49%

 # Not a tax year under appeal but relevant for this appeal.

15. By a letter dated 3 November 1998, the Taxpayer, through his present representative, gave notice of appeal to the Board of Review against the assessments to the section 82A additional tax in respect of 3 out of the 6 years of assessment under section 82B of the IRO. The 3 years of assessment under appeal are the years of assessment 1991/92, 1993/94 and 1994/95.

Categories of the incomes omitted or understated

16. To understand this appeal and its slightly complex factual matrix, we set out below (i) the 3 categories of the incomes which the IRD alleges were omitted or understated in the 3 tax returns in question and (ii) our further findings of the facts relating to these categories based on the submissions of the parties and the documents submitted to us:

a. The 2 special bonuses to the Taxpayer as director of the Company resolved to be paid to the Taxpayer by the board of directors of the Company ('Special Bonus') which is further divided into 2 sub-categories of:

   i. $20,000,000 for the period 1991/92 ('$20M Special Bonus') and

   ii. $10,000,000 for the period 1993/94 ('$10M Special Bonus').

b. The rental value of $414,000 for each of the years of assessment 1991/92 ('91/92 Rental Value') and 1993/94 ('93/94 Rental Value')

c. The director's expense allowance of $860,000 for the year of assessment 1994/95 ('Director's Expense Allowance')

(a)(i) $20M Special Bonus

17. The IRD's case is that the incomes not reported by the Taxpayer in his tax return for the year of assessment 1991/92 dated 2 May 1992 were (i) the $20M Special Bonus awarded by the Company in favour of the Taxpayer and (ii) the 91/92 Rental Value. Hence the total understated income of $20,414,000 found in paragraph 12 above.

18. On 29 April 1992, the Company filed an employer's return for the year of assessment 1991/92 relating to the Taxpayer showing the Taxpayer having received total a remuneration of $4,536,000. The Taxpayer as director of the Company, signed the employer's return on behalf of the Company. A few days later on 2 May 1992, the Taxpayer filed his own salaries tax return for the year of assessment 1991/92 declaring an income of $4,536,000.

19. According to the submission of the Taxpayer's representative and documents presented by the representative, the $20M Special Bonus accrued to the Taxpayer after he filed his tax return for the year of assessment 1991/92. It is found in the Company's books under the director's account as an audit adjustment after finalization of the audited accounts for the year of assessment 1991/92 and approval of its payment on 27 August 1992. This is evidenced by minutes of a meeting of the Company's board of directors dated 27 August 1992 which was appended to the Taxpayer's statement of facts submitted by the Taxpayer's representative in response to the IRD's statement of facts. These same minutes approved the Company's accounts for the year of assessment 1991/92 and the signing of the audited accounts. It resolved (amongst other things) that '*special bonus for a director [the Taxpayer] for $20,000,000 in respect of the year ended 31 March 1992 be hereby approved and confirmed.*'

20. Also submitted to this Board by the Taxpayer's representative was a covering memo from the auditors to the Company dated 27 September 1992 enclosing the audit adjustment (which included the $20M Special Bonus addition as journal adjustment entries to the directors' remuneration and directors' current accounts). This covering memo asked the Company to adjust its books using the audit adjustments. We note the peculiar chronology of the board minutes and auditor's memo. The peculiarity is that the $20M Special Bonus audit adjustment was done by the auditor in September whereas the board minutes approving the $20M Special Bonus and the audited accounts was in August, one month before the audit adjustment. The audited accounts itself was dated 27 August 1992 and it showed a total directors' remuneration of $26,048,000 (which included the $20M Special Bonus).

21. Unlike the $10M Bonus for the year of assessment 1993/94 (which is mentioned in the following sub-heading), the Company had not filed a supplemental employer's return to report this additional $20M to the IRD.

(a)(ii) $10M Special Bonus

22. The IRD's case for the amounts understated for the year of assessment 1993/94 is similar to the year of assessment 1991/92 except that the major differences were that (i)

the Special Bonus was $10M and (ii) the Company did report this $10M in a supplemental employer's return.

23. On 30 April 1994, the Company filed its employer's return reporting a total director remuneration of $6,600,000 for the year of assessment 1993/94. A little over 2 months later on 10 June 1994, the Taxpayer filed his tax return for individual for the year of assessment 1993/94 reporting salaries and bonus of $6,600,000.

24. Again it is the submission of the Taxpayer's representative that the $10M Special Bonus was resolved in a directors' meeting dated 11 August 1994 in which meeting the audited accounts for the year of assessment 1993/94 were also approved (in similar language as the 27 August 1992 board minutes for the $20M Special Bonus for the year of assessment 1991/92). A copy of the minutes of this meeting was produced to us. Hence when the Taxpayer filed his tax return for the year of assessment 1993/94 in June, the Taxpayer's case is that it was correct. Further, this time, the Company filed a supplemental employer's return in respect of the $10M Special Bonus on 7 September 1994. The Taxpayer had signed this supplemental employer's return as director of the Company.

25. At first, it was difficult to understand why the IRD alleges that the omitted income for the tax return for the year of assessment 1993/94 was $6,600,000. Logically, the omitted income would be $10,414,000 (comprising of the omitted $10M Special Bonus and the $414,000 93/94 Rental Value). The Taxpayer had clearly filed his tax return for the year of assessment 1993/94 showing the income of $6,600,000 (and a further $25,000 from another company as well). Assuming that the $10,000,000 should have been declared in the Taxpayer's tax return for the year of assessment 1993/94, then the omitted or understated income (if we were to ignore the $414,000 93/94 Rental value) should have been $10,000,000 (and not $6,600,000 as claimed by the IRD).

26. The reason for this became clear in the IRD's submission to us. Since the Company filed the supplemental employer's return for the $10,000,000, when the assessor made his initial tax assessment of $10,025,000, he based it on the Company's supplemental employer's return of $10,000,000 instead of the Taxpayer's return for the year of assessment 1993/94. Yet for some unknown reason, the assessor also included the $25,000 from another company reported in the Taxpayer's tax return for the year of assessment 1993/94 while ignoring the $6,600,000 in the same tax return. Due to this distorted and convoluted manner of arriving at the initial assessment for the year of assessment 1993/94 by the IRD, the taxable income understated became $6,600,000. This error was used by the Taxpayer as one of his grounds for this appeal.

(a)(iii) Special Bonus board minutes

27. Before we can decide on the merits of the Taxpayer's ground that the relevant tax returns were correct, we must first decide whether to accept the Taxpayer's submission and the evidence presented to prove the accrual of the $20M and $10M Special Bonuses subsequent to the tax returns. The board minutes were not produced through sworn

testimony. The date of the board minutes for the year of assessment 1991/92 does not chronologically tie in with the auditor's memo for the audit adjustment as noted in paragraph 20 above. On the other hand, the board minutes and auditor's memo were not challenged by the Revenue. The Taxpayer's representative submitted that the decision to pay the director's bonus was made each year after the accounts have been audited. Further similar facts occurred for a $8,000,000 bonus in the year of assessment 1996/97 approved in December 1997 (the tax return for that year being submitted on 20 May 1997) and the IRD has not sought to impose additional tax for the 'omission' for that tax year. The reason for this could well be that the Taxpayer had notified the IRD of this additional $8,000,000 bonus by letter date 28 May 1998 (although from our analysis of the present drafting of the IRO appearing below, a taxpayer may not be under any statutory obligation to give this notification).

28. Given the haphazard manner of keeping of the books of the businesses of the Taxpayer, we are prepared to give the benefit of the doubt to the Taxpayer in finding that the Special Bonuses were resolved to be given to the Taxpayer by the Company after the accounts have been finalized and audited. Since the Company's accounts were not finalized by the time the Taxpayer filed his tax returns, we find that the Special Bonuses had not come into existence at the time of his filing of the relevant tax returns.

(b)91/92&93/94 Rental Values of $414,000

29. For the years of assessment 1991/92 and 1993/94, IRD's tax investigations revealed that the Taxpayer had received benefits in the form of Rental Value of $414,000 for each year. But the Taxpayer had not reported this in his tax returns for those two tax years. It is not clear from the papers and submission from both parties as to the circumstances under which the $414,000 Rental Values were omitted from the Taxpayer's tax returns for the years of assessment 1991/92 and 1993/94. No explanation was given other than the submission that the amount had been disclosed by the Company (but not the Taxpayer) in the audited financial statements of the Company submitted to the IRD when the Company filed its own profits tax returns for those two years in question. No documentary evidence was submitted by the Taxpayer for the omitted 91/92 and 93/94 Rental Values of $414,000 each. In the hearing of this appeal, the Taxpayer's representative has frankly admitted these omissions.

(c) 1994/95 Director's Expense Allowance of $860,000

30. The Director's Expense Allowance of $860,000 was not included in the Taxpayer's tax return for the year of assessment 1994/95. This Allowance was revealed in the supporting schedules to the Company's audited financial statement when the Company filed its own profits tax return. The Taxpayer's case is that this amount was a reimbursement of business expenses incurred by the Taxpayer for the Company and not income or benefit received by the Taxpayer and that at the time when his own tax return was filled in, he had a genuine belief that he was not chargeable to tax on this item. No

documentary evidence was submitted by the Taxpayer for the omitted $860,000 Director's Expense Allowance.

Issues

31. The issues to be addressed in this appeal are whether the Taxpayer had reasonable excuse in omitting the 3 categories of income set out above and whether the additional taxes in respect of the each of the 3 years were excessive having regard to the circumstances.

32. In particular, the difficulty with this appeal is in addressing these issues for the Special Bonus category. What should be the correct treatment of the 2 Special Bonuses of $20M and $10M which were awarded to the Taxpayer by his employer, the Company, after the Taxpayer has already filed his tax returns for those particular tax year? Were the tax returns correct, given that at the time of filing of the tax returns, the Special Bonuses have not yet been resolved by the Company to be paid to the Taxpayer? If the filed tax returns were correct, then section 82A additional tax could not be imposed on the Taxpayer. If the filed tax returns were incorrect, did the Taxpayer have a reasonable excuse in omitting these Special Bonus from his tax returns? Further, were the additional tax levied as a result of the omissions of the Special Bonus excessive having regard to the circumstances?

Applicable law

33. The statutory duty of taxpayers to make returns and provide information and the investigative powers of the IRD are found in Part IX of the IRO. For this appeal, the relevant section on making returns and providing information is in section 51 as follows:

> Section 51
>
> *'(1) An assessor may give notice in writing to any person requiring him within a reasonable time stated in such notice to furnish any return which may be specified by the Board of Inland Revenue for –*
>
> *(a) property tax, salaries tax or profits tax; or*
>
> *(b) property tax, salaries tax and profits tax,*
> *under Parts II, III, IV, XA, XB and XC, containing such particulars and in such form as may be specified by the Board of Inland Revenue.*

(2) Every person chargeable to tax for any year of assessment shall inform the Commissioner in writing that he is so chargeable not later than 4 months after the end of the basis period for that year of assessment unless he has already been required to furnish a return under the provisions of subsection (1).'

34. Additional or penalty tax is levied on taxpayers for making incorrect tax returns or give wrong information or statements or fails to comply with tax reporting requirements. The charging provision in the IRO is section 82A and the relevant subsections (1) and (ii) are set out herein:

Section 82A

'(1) Any person who without reasonable excuse –

(a) makes an incorrect return by omitting or understating anything in respect of which he is required by this Ordinance to make a return, either on his behalf or on behalf of another person or a partnership; or

(b) makes an incorrect statement in connection with a claim for any deduction or allowance under this Ordinance; or

(c) gives any incorrect information in relation to any matter or thing affecting his own liability to tax or the liability of any other person or of a partnership; or

(d) fails to comply with the requirements of a notice given to him under section 51(1) or (2A); or

(e) fails to comply with section 51(2),

shall, if no prosecution under section 80(2) or 82(1) has been instituted in respect of the same facts, be liable to be assessed under this section to additional tax of an amount not exceeding treble the amount of tax which-

(i) has been undercharged in consequence of such incorrect return, statement or information, or would have been so undercharged if the return, statement or information had been accepted as correct; or

(ii) has been undercharged in consequence of the failure to comply with a notice under section 51(1) or (2A) or a failure to comply with section 51(2), or which would have been undercharged if such failure had not been detected.

(2) Additional tax shall be payable in addition to any amount of tax payable under an assessment, or an additional assessment under section 60.'

35. The applicable law on appeals to the Board against section 82A additional tax is found in section 82B of the IRO.

Section 82B

'(1) Any person who has been assessed to additional tax under section 82A may, within 1 month after notice of assessment is given to him, give notice of appeal to the Board; but no such notice shall be entertained unless it is given in writing to the clerk to the Board and is accompanied by –

(a) a copy of the notice of assessment;

(b) a statement of the grounds of appeal from the assessment;

(c) a copy of the notice of intention to assess additional tax given under section 82A(4), if any such notice was given; and

(d) a copy of any written representations made under section 82A(4).

(2) On an appeal against assessment to additional tax, it shall be open to the appellant to argue that –

(a) he is not liable to additional tax;

(b) the amount of additional tax assessed on him exceeds the amount for which he is liable under section 82A;

(c) the amount of additional tax, although not in excess of that for which he is liable under section 82A, is excessive having regard to the circumstances.

(3) Sections 66(2) and (3), 68, 69 and 70 shall, so far as they are applicable, have effect with respect to appeals against additional tax as if such appeals were against assessments to tax other than additional tax.'

36. By virtue of section 82B(3), section 68(4) applies in this appeal with modification. Section 68(4) states that *'the onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant'*.

Taxpayer's grounds of appeal

37. In substance, the Taxpayer's grounds in this appeal are as follows:

a. The 3 tax returns of the taxpayer in this appeal were correct. For the tax returns for the years of assessment 1991/92 and 1993/94 the Special Bonuses did not exist when these tax returns were filed. For the return for the year of assessment 1994/95, the omitted Director's Expense Allowance was a reimbursement of business expenses incurred by the Taxpayer for the Company and was, therefore, not income which needed to be reported in the tax return for the year of assessment 1994/95.

b. Even if the tax returns were incorrect, the Taxpayer had reasonable excuse under section 82A in making the incorrect returns. The $20M and $10M Special Bonuses were not established when the respective tax returns for the years of assessment 1991/92 and 1993/94 were filed. As for the return for the year of assessment 1994/95, the Taxpayer had a genuine belief that the omitted Director's Expense Allowance was not taxable income.

c. The additional taxes for the 3 tax years were excessive in the circumstances because:

i. Through the tax filings of the Company, which is controlled and signed by the Taxpayer, the Taxpayer had already disclosed to the IRD the Special Bonuses, the Rental Value and the Director's expense allowance. The employer's returns, the audited accounts and all information provided by the Company to the IRD were signed by the Taxpayer. It was up to the IRD to match the employer and employee tax filings to come up with an accurate assessment in respect of the employee's taxable income.

ii. The $10M Special Bonus was the subject of an additional supplemental employers return filed by the Company (with the Taxpayer signing on behalf of the Company) and thus reported twice to the IRD (in addition to the profits tax filings of the Company).

iii. The unassessed income of $6,600,000 for the year of assessment 1993/94 was not understated by the Taxpayer but caused by the error in the initial assessment of the IRD.

iv. The Taxpayer had cooperated with the IRD.

v. The Special Bonuses have not been actually received by the Taxpayer.

vi. The income omissions were found with no or minimal investigative effort because the omitted incomes can be found in the tax filings of the Company.

vii. The Taxpayer was very involved in his business and he left matters relating to accounting to the account manager whom he employed. The account manager and the auditor of the Company made the mistakes which were not known to the Taxpayer. In the documents submitted to us, the account manager had made written admissions of the mistakes caused by heavy workload, labour shortage and computer problems.

viii. All the cases cited by the IRD related to understatements of business profits involving cover-up tactics which should not be compared with the Taxpayer's unassessed employment income.

38. We with deal with Special Bonuses first as they constitute the crux of this appeal. We will then deal with the other omitted incomes and the case put forward by the Taxpayer to say that the additional taxes were excessive in the circumstances.

The correct tax returns

39. Insofar on the $20M and $10M Special Bonuses are concerned, the strongest argument from the Taxpayer was that the tax returns concerning the years of assessment 1991/92 and 1993/94 were correct as at the date of their filings (viz respectively 2 May 1992 and 10 June 1994). At the time of the filing of the tax returns, the board of directors of the Company (controlled by the Taxpayer) had not yet decided to give the Special Bonuses. This was done afterwards respectively in August or September 1992 and August 1994 when the accounts have been audited. Hence as at the date of the tax returns, the tax returns were correct. The Revenue's arguments on this issue were that (i) the Special Bonuses had accrued to the Taxpayer as at the relevant balance sheet date and (ii) the income was already there at the time of filing of the tax return. We are not convinced by the Revenue's argument on this issue. A taxpayer declares in his tax return $X income. Subsequently, this employer then decides to give him a bonus of $Y which is taxable. This does not render his tax return incorrect as at the time of filing his tax return. The taxpayer simply did not know that he will have an extra $Y income accruing to him. Even if the taxpayer were in the position to control his employer (for example, as shareholder and/or director of the employer), the legal reality is that the bonus was not his until the employer decided to award the bonus to him. After the decision is made to award the bonus (and thus accrued) to the taxpayer, this bonus may be deemed to be income if it has been made available to the taxpayer under the proviso in section 11D(a) of the IRO. On this analysis, the tax return were correct and there is no omission or understatement and no incorrect return, statement or information under which section 82A additional tax can be levied. This raises a different side issue: whether a taxpayer, in the circumstance of the present Taxpayer, should have filed a subsequent

supplemental tax return or inform the IRD of the subsequent bonus and whether failure to do so would entitle the IRD to charge the section 82A additional tax.

40. We have not been able to locate any such statutory obligation to file a supplemental return in respect of additional income subsequent to filing a tax return. The closest statutory provision that can be found is section 51(2) of the IRO. But its proviso clearly states that it is not applicable once a return has already been furnished. In *Dodge Knitting Co Ltd, Dodge Trading Ltd v CIR (1989) 2 HKTC 597 at 607*, in answer to the question in an appeal to the High Court of 'whether the issuance of a profits tax return excuses a taxpayer from complying with the requirements of section 51(2) of the IRO', the High Court answered the question in the affirmative. In the absence of express statutory provisions, we are of the view that there is no statutory obligation on a taxpayer to file a supplemental return or inform the IRD of subsequent taxable income for a tax year which has come to his knowledge after he has filed his tax return for that tax year. In any event, even if there were a duty on a taxpayer to file supplemental tax returns, the wording of section 82A is insufficient to allow imposition of the additional tax since it caters to only situations where incorrect returns, statements or information are given rather than not volunteering new information. This, however, is a side issue only and does not affect the final outcome in this appeal.

Date of accrual of special bonuses

41. As at the date of filing of tax return, the Special Bonus for the same tax year had not come into existence. The tax return would be therefore correct and no section 82A additional tax could be charged. But this does not mean that the Taxpayer did not have to ever declare to the IRD the Special Bonus income. We are of the view that the Special Bonuses should have been declared by the Taxpayer in the tax returns for the tax years in which the resolutions in the board minutes authorizing the same were passed. In other words, the $20M Special Bonus should have been declared in the Taxpayer's tax return for the year of assessment 1992/93 (rather than the tax return for the year of assessment 1991/92) and the $10M Special Bonus should have been declared in the Taxpayer's tax return for the year of assessment 1994/95 (rather than the tax return for the year of assessment 1993/94). To come to this conclusion, we applied the proviso in section 11(D)(a) of the IRO which is set out below:

> Section 11D(a)
>
> '*income which has accrued to a person during the basis period for a year of assessment but which has not been received by him in such basis period shall not be included in his assessable income for that year of assessment until such time as he shall have received such income, when notwithstanding anything contained in this Ordinance, an additional assessment shall be raised in respect of such income:*

> *Provided that for the purposes of this paragraph income which has either been made available to the person to whom it has accrued or has been dealt with on his behalf or according to his directions shall be deemed to have been received by such person;'*

42. The Taxpayer does not have to have actually received the Special Bonuses. Section 11D(3) deems that the Special Bonuses have been received if they have been made available or have been dealt with. We are of the view that the Special Bonuses have been '*made available'* to the Taxpayer or '*has been dealt with on his behalf*' at the time when the Special Bonus board resolutions were passed and when the directors current account in the Company's balance sheet was adjusted. The audit adjustments were made by crediting the directors' current account with the Special Bonuses, as at the last day of the Company's financial year end (which coincided with the last day of tax year end), in which the Special Bonus was expressed to given. All that was left to be done in order that the Special Bonuses can be paid to the Taxpayer was for the Taxpayer to sign a cheque or direct payment as a director of the Company to pay the Special Bonuses to himself. The IRD has argued that since the $20M and $10M Special Bonuses were credited to the Taxpayer in the balance sheet of the Company for the respective years of assessment 1991/92 and 1993/94, the Special Bonus had respectively accrued to the Taxpayer in those tax years and the Taxpayer had omitted these Special Bonuses in the respective tax returns for those tax years. We disagree with this analysis. The fact still remains at the end of financial years to which the Special Bonuses relate (viz 30 March 1992 and 30 March 1994), no decision had been made by the Company to give the respective $20M and $10M Special Bonuses. The decision for the $20M Special Bonus took place only in August 1992. Likewise the decision for the $10M Special Bonus took place in August 1994.

43. We are mindful that there can well be situations where a resolution of an employer to pay additional taxable income may not be sufficient for the purpose of determining that such additional taxable income has been '*made available*' to the taxpayer or '*has been dealt with on his behalf or according to his directions'* under the proviso to section 11D(a). Further acts may be required; such as informing the taxpayer. Each case depends on its own individual facts and circumstances. In the circumstances of the present appeal, given that the Taxpayer is the controlling mind of the Company, once the Special Bonuses resolutions were passed, the section 11D(a) proviso applied and the Special Bonuses became declarable income for the tax years in which the resolutions were passed.

Tax returns for the years of assessment 1991/92 and 1993/94 still incorrect

44. Despite our view that there were no omissions of the $20M Special Bonuses in the tax return for the year of assessment 1991/92 and the $10M Special Bonuses in the tax return for the year of assessment 1993/94, these two tax returns were still incorrect. This is because of the omission of the 91/92 and 93/94 Rental Values for those two periods. This omission is frankly admitted by the Taxpayer.

Tax returns for the year of assessment 199/95 still incorrect

45. The tax return for the year of assessment 1994/95 was incorrect for 2 reasons:

a. The Director's Expense Allowance was still omitted. No evidence was presented by the Taxpayer to substantiate whether the expenses allowance expenditures were incurred by the Taxpayer wholly for the Company or to substantiate the Taxpayer's belief that expense allowance was not taxable income.

b. The $10M Special Bonus had, on our analysis, accrued in the year of assessment 1994/95 being the period in which the Company passed the $10M Special Bonus resolution dated 11 August 1994. This $10M Special Bonus was not declared in the Taxpayer's tax return for the year of assessment 1994/95.

Inability to argue that assessment was incorrect

46. The IRD has sought to argue that the Taxpayer 'is not at liberty to adduce evidence for the purpose of proving that the amounts of income assessed for those years of assessment that have become final and conclusive were excessive or incorrect'. Previous Board decisions in D36/88, IRBRD, vol 3, 354 and D42/88, IRBRD, vol 3, 395 were cited in support. These previous Board decisions allowed evidence to be produced to show a taxpayer's belief at the time of filing of his tax return that any omitted income were not chargeable to tax. We agree that these decisions show that a taxpayer could not argue in section 82B appeals that the assessment with respect to which the penalty was levied was incorrect. The Taxpayer had not sought to do so in this appeal. The Taxpayer is not arguing that assessments were incorrect, he is arguing that the tax returns were not incorrect. The Taxpayer is allowed to adduce evidence to show this.

Other grounds to say that the section 82A tax was excessive

47. Other than the difficult issue of the Special Bonuses and whether the relevant tax returns were correct, none of the other arguments advanced by the Taxpayer's representative persuades us to the view that the additional tax and rate used to calculate the section 82A penalty in this appeal are excessive in the circumstances based on the various authorities which the IRD's representative had so ably demonstrated to us.

48. The Taxpayer has offered no evidence at all on whether he had genuinely believed that the Director's Expense Allowance of $860,000 for the year of assessment 1994/95 was not chargeable as his income. If anything at all, from the documents which we have seen, it is likely that the Taxpayer did not even know or care about this expense allowance. We therefore reject this ground.

49. The Taxpayer cannot rely on the Company's tax filings and replies to IRD queries to satisfy his personal duty to disclose his own personal income which are required

under the provisions of the IRO. The Company and the Taxpayer are separate legal entities. It is not up to the IRD to try and match employer/payer and employee/payee tax filings to assess the taxable income of the employee/payee. The individual payee's duties in making the tax filings are clear and unambiguous. The Taxpayer's arguments in this regard are totally misconceived and rejected.

50. The peculiar manner in which the IRD made the initial assessment of a taxable income of $10,025,000 for the year of assessment 1993/94 (which the IRD had admitted as an inadvertent error) cannot be used as an excuse by the Taxpayer. Had no error been made the Taxpayer would have been assessed on his tax return for the year of assessment 1993/94 of $6,625,000 as taxable income. His income understated would then have been an extra $3,600,000 which would have increased his section 82A additional tax.

51. The grounds relating to incompetent staff or professional and pressure of business in the circumstances of this appeal cannot be supported under present case law. As cited by the IRD and stated in D46/89:

> *'The Taxpayer ... was fully capable of running a profitable business. He must be aware that ... it is his duty to ensure correct tax returns are filed within the time permitted. When he fails in his duty, he cannot excuse himself by blaming it on the incompetence of staff. The engagement of qualified and competent staff is his own responsibility and he has to take the consequences if he fails to take proper measures in engaging staff. Neither can lack of accounting knowledge, nor ignorance of law and limited education be considered as reasonable excuses. As for negligence of the professional accountant, this again cannot be accepted as an excuse.'*

The view can also be found in D34/88, IRBRD, vol 3, 336 and D43/89, IRBRD, vol 4, 484. We further note that the accounting manager appeared to have been hired to keep the books of the Company and the Taxpayer's other companies. It was neither the accounting manager's duty nor the duty of the auditors of the Company to keep record the Taxpayer's personal finances or even to make up and file his personal tax returns. To attempt to blame the accounting manager and the auditor points to the irresponsible attitude of the Taxpayer.

52. The only mitigating factor is the cooperation of the Taxpayer and his prompt payment of the taxes on the unaccessed incomes. According to the IRD, this is already reflected in the consideration of the quantum of the additional tax.

Conclusion

53. For the incorrect tax returns for the years of assessment 1991/92 and 1993/94, given that the omission was only for the $414,000 Rental Value, the additional tax charged could only have been on the basis of the $414,000 omission (without taking the Special Bonuses into consideration). In the circumstances, the additional taxes of $1,725,000 and $538,000 for the years of assessment 1991/92 and 1993/94 were excessive.

54. The Taxpayer succeeds partially in his appeals section 82A additional tax for the years of assessment 1991/92 and 1993/94, which appeals are, to that extent, allowed. We direct that the additional tax for the years of assessment 1991/92 and 1993/94 should be based on only the $414,000 Rental Value understated. If not for the peculiar circumstances which resulted in the legitimate exclusion of the Special Bonuses in the Taxpayer's tax returns for the year of assessment 1991/92 and 1993/94, we would have had no hesitation in dismissing this appeal. The Taxpayer only has himself to blame and brought the tax investigation on to himself in neglecting the financial management and book-keeping of his businesses and personal affairs. Despite the fallacious argument that the filing of the Company's profit tax returns and audited accounts constitutes the Taxpayer informing the IRD of his income, the Taxpayer could not explain why he had not caused the Company to file a supplemental employer's return for the 1991/92 $20M Special Bonus. Further if the Taxpayer had genuinely intended to declare the Special Bonuses to the IRD for tax purpose, it was open to him to declare the Special Bonuses in his tax returns for the subsequent tax year. The Taxpayer had made no mention of these Special Bonuses in his tax returns for the subsequent years. These factors together with his previous records of tax reporting omissions merit imposing additional tax at a higher rate than the usual 10% to 20% of the tax undercharged.

55. As for the percentage of tax charge that we should use in arriving at the new additional tax, we can see no reason for the different percentages used in the 6 basis periods which the IRD had combined in its section 82A(4) notice of intention to impose additional tax in paragraph 13 above. We therefore take the average of the percentages in those 6 years which works out to 62.3%. Hence the section 82A additional tax for each of omission in the years of assessment 1991/92 and 1993/94 is 62.3% of the tax undercharged ($62,100). The result is $38,688.30 additional tax for the omission in the year of assessment 1991/92 and the same amount for the omission in the year of assessment 1993/94. This is a substantial reduction of the IRD's section 82A additional taxes of $1,725,000 for the year of assessment 1991/92 and of $538,000 for the year of assessment 1993/94 despite our lack of sympathy for the Taxpayer's case.

56. In so far as the 1991/92 Special Bonus of $20M is concerned, the Taxpayer never had the intention of declaring it to the IRD. The Taxpayer has never declared it in any of his tax returns subsequent to the tax return for the year of assessment 1991/92. Further, the Taxpayer had not, in his capacity as director of the Company, informed the IRD of this Special Bonus in any supplemental employer's return. Technically, he had omitted this Special Bonus in his tax return for the year of assessment 1992/93 which has not been appealed against and is not part of this appeal. Therefore, we make no rulings on this omission.

57. As for the 2 omissions in the return for the year of assessment 1994/95, the basis upon which the section 82A additional tax should have been charged should be the total understated income of $10,860,000 (being the $10M Special Bonus and Director's Expense Allowance of $860,000) rather than $860,000. The tax undercharged is $1,629,000 rather

than $129,000. We are empowered to increase the additional tax under section 82B(3) which applies section 68(8)(a). Section 82A(1) states that : any person who makes an incorrect return shall be liable to be assessed additional tax of an amount not exceeding treble the amount of tax which '*would have been undercharged if the return had been accepted as correct*'. In the circumstances, the Taxpayer's appeal against the section 82A additional tax for the year of assessment 1994/95 is dismissed. Further, the additional tax for the year of assessment 1994/95 is increased to $1,014,867 by using $1,629,000 (the tax undercharged) and applying thereto the above mentioned percentage of 62.3%. The total additional tax for the year of assessment 1994/95 is $1,014,867 which represents an increase of $885,867 from the original additional tax of $129,000.

58. For the avoidance of doubt, this Board's decision for the additional tax on the 3 years of assessment is as follows:

Year of Assessment	**Income Understated**	**Tax Undercharged**	**Section 82A Additional Tax**	**Percentage of Tax Undercharged**
	$	$	$	
1991/92	414,000	62,100	38,688.30	62.3%
1992/93	414,000	62,100	38,688.30	62.3%
1994/95	10,860,000	1,629,000	1,014,867.00	62.3%