

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D36/99

Penalty Tax – standard practice of Inland Revenue Department to draw attention of the taxpayer the possibility to impose penalty tax – whether withdrawal of the objection was part of a full and final settlement – whether the Commissioner was barred to assess penalty tax.

Panel: Ronny Wong Fook Hum SC (chairman), Michael Seto Chak Wah and Ronald Tong Wui Tung.

Date of hearing: 24 April 1999.

Date of decision: 16 July 1999.

The taxpayer commenced his business as an insurance agent on 1 May 1985. On 16 November 1996, the Inland Revenue Department commenced to inquire into the details of expenses charged in the taxpayer's business accounts for the year of assessment 1995/96. On 7 March 1997, the assessor found that the expenses could not be fully deducted for profits tax purposes and raised on the taxpayer additional profits tax assessments. The taxpayer lodged objections against the additional profits tax assessment for the year of assessment 1990/91 to 1995/96. The objections were acknowledged.

On 18 February 1998, the taxpayer lodged a formal withdrawal of his objection. On 26 October 1998, the Commissioner gave notice to the taxpayer under section 82A(4) of the IRO informing him of his intention to assess the taxpayer to additional tax by penalty in respect of the years of assessment 1990/91 to 1995/96.

The taxpayer gave evidence and it was the taxpayer's case that he withdrew his objection and accepted the additional profits tax because the assessor in charge of his file at a meeting with the taxpayer on 18 February 1998 indicated that no further assessments would be made for the years in question and he further pointed out that the assessor made no mention about penalty.

Held:

- (1) The Board has had the opportunity of seeing the taxpayer and hearing his evidence. The Board found that the taxpayer was honest and straight forward and the Board found that the assessor departed from the standard practice of the Inland Revenue Department in drawing taxpayer's attention at the time of compromise to the possibility of penalty tax and the assessor deliberately

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refrained from warning the taxpayer of such possibility prior to the withdrawal of the objections by the taxpayer.

- (2) The Board found that the withdrawal of the taxpayer to object was part and parcel of an overall settlement between the taxpayer and the Inland Revenue Department. The withdrawal would represent completion of his case and closure of his file. The Commissioner is debarred on the basis of such settlement to assess penalty tax.

Appeal allowed.

Tong Cheng Yuet Kiu for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

The facts

1. This is an appeal by the Taxpayer against the imposition of additional tax by way of penalty under section 82A of the Inland Revenue Ordinance assessed upon him for the years of assessment 1990/91, 1991/92, 1992/93, 1993/94, 1994/95 and 1995/96.
2. The Taxpayer commenced his business as an insurance agent [‘the Business’] on 1 May 1985.
3. The Taxpayer submitted the following profits tax returns:

<u>Year of Assessment</u>	<u>Basis Period</u>	<u>Date of Filing of Return</u>	<u>Profits Returned</u> \$
1990/91	31-3-1991	10-9-1991	85,056
1991/92	31-3-1992	15-10-1992	96,560
1992/93	31-3-1993	12-11-1993	176,453
1993/94	31-3-1994	10-10-1994	174,928
1994/95	31-3-1995	18-10-1995	188,197
1995/96	31-3-1996	24-9-1996	269,796

4. On the basis of the returns so submitted, the assessor raised the following profits tax assessments:

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Year of Assessment Profits Returned Profits Assessed Tax Payable under Personal Assessment

	\$	\$	\$
1990/91	85,056	85,056	4,581
1991/92	96,560	112,344	9,355
1992/93	176,453	176,453	20,130
1993/94	174,928	174,928	13,372
1994/95	188,197	188,197	15,647
1995/96	269,796	269,796	24,924

5. On 16 November 1996, the Inland Revenue Department commenced to inquire into the details of expenses charged in the Taxpayer's business accounts for the year of assessment 1995/96. An incomplete reply was furnished by the Taxpayer on 10 December 1996.

6. On 7 March 1997, the assessor issued a letter to the Taxpayer explaining why the expenses could not be fully deducted for profits tax purpose. The assessor further raised on the Taxpayer additional profits tax assessments:

<u>Year of Assessment</u>	<u>Profits Assessed</u>	<u>Additional Assessable Profits</u>	<u>Additional Tax Payable</u>
	\$	\$	\$
1990/91	85,056	233,595	47,797
1991/92	112,344	251,892	54,635
1992/93	176,453	281,556	68,701
1993/94	174,928	283,116	42,467
1994/95	188,197	330,730	49,610
1995/96	269,796	307,559	61,511

7. On 21 March 1997 the Taxpayer lodged objections against the additional profits tax assessment for the year of assessment 1990/91 to 1995/96. He offered to have an amount equal to two-thirds of the total income for the years in question to be treated as deductible expenses and one-third to be taxable.

8. The objections were acknowledged on 17 April 1997 and on 5 August 1997 the assessor raised further queries on the expenses charged in the accounts.

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9. On 30 October 1997, the Taxpayer replied in respect of the queries raised for the year of assessment 1995/96 and requested for time to reply to the queries raised for the years of assessment 1990/91 to 1994/95.

10. On 8 December 1997, the assessor issued a reminder to the Taxpayer for his response to the outstanding queries. On 12 December 1997, the Taxpayer requested for further extension of time.

11. On 18 February 1998, the Taxpayer lodged a formal withdrawal of his objection [‘the Withdrawal’] in respect of the additional profits tax assessments for the years of assessment 1990/91 to 1995/96.

12. On 20 February 1998, the Taxpayer lodged a request for payment of tax by instalment. His request was acceded to by the assessor on 27 March 1998.

13. On 26 October 1998, the Commissioner gave notice to the Taxpayer under section 82A(4) of the Inland Revenue Ordinance informing him of his intention to assess the Taxpayer to additional tax by way of penalty in respect of the years of assessment 1990/91 to 1995/96.

14. On 24 November 1998 the Taxpayer submitted written representations in response to the section 82A(4) notice. The Taxpayer pointed out that the Withdrawal was the result of a meeting which he had with Mr Lee Pak Yin [‘Mr Lee’], assessor in charge of his file, on 18 February 1998. He alleged that Mr Lee indicated that no further assessments would be made for the years in question. He further pointed out that Mr Lee made no mention about penalty. It was on this basis that he withdrew his objection and accepted the additional profits tax.

15. On 20 January 1999 the Commissioner, after considering the Taxpayer’s representations, imposed additional tax under section 82A in the following amounts:

<u>Year of Assessment</u>	<u>Tax that would have been Undercharged</u>	<u>Section 82A Additional Tax</u>	<u>Additional Tax as Percentage of Tax that would have been Undercharged</u>
	\$	\$	
1990/91	43,216	32,000	74.04%
1991/92	45,280	33,000	72.88%
1992/93	48,571	36,000	74.11%
1993/94	55,334	37,000	66.86%
1994/95	62,191	36,000	57.88%
1995/96	61,511	31,000	50.39%

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16. By letter dated 12 February 1999, the Taxpayer appealed against these assessments under section 82A.

Hearing before us

17. The bone of contention centred round what transpired at the meeting between the Taxpayer and Mr Lee on 18 February 1998. The Taxpayer asserted that he asked Mr Lee whether his withdrawal would represent completion of his case and closure of his file. He obtained Mr Lee's confirmation. Mr Lee gave no indication that he might be further assessed under section 82A.

18. Mr Lee also gave sworn evidence before us. He maintained that the meeting only discussed the notice of objection. There was no discussion at all on the issue of penalty.

19. We have to decide on an objective basis whether the parties agreed that the Withdrawal was part of a full and final settlement of the Taxpayer's tax affairs for the years in question. The Taxpayer is not a man with sophistication. However we find him honest and straight forward. Mr Lee certainly has superior knowledge. However he departed from the standard practice of the Inland Revenue Department in drawing Taxpayer's attention at the time of compromise to the possibility of penalty tax. We are of the view that he deliberately refrained from warning the Taxpayer of such possibility prior to the Withdrawal.

20. We find as a fact that the Withdrawal was part and parcel of an overall settlement between the Taxpayer and the Revenue. The Withdrawal would represent completion of his case and closure of his file. The Commissioner is debarred on the basis of such settlement to assess penalty tax.

21. For these reasons, we would reduce the assessment for each of the years in question to nil.