

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D3/96

**Penalty tax** – submitting incorrect salaries tax returns – additional tax – section 82A of Inland Revenue Ordinance.

Panel: William Turnbull (chairman), Erwin A Hardy and Elsie Leung Oi Sie.

Date of hearing: 12 February 1996.

Date of decision: 24 April 1996.

The taxpayers were couples and were the owners and directors of a company dealing with plastic housewares. The husband submitted incorrect salaries tax returns for a period of 2 years. The wife did not file any salaries tax return for a period of 3 years. The assessor investigated into the tax affairs of the taxpayers. The taxpayers then proposed to settle the investigation at a total understatement of \$1,400,000.

The Commissioner imposed additional tax under section 82A. The additional tax each year as percentage of tax undercharged was 127% for the husband and 115% for the wife.

Held:

The Board does not consider the penalties imposed were excessive. It was quite clear that the taxpayers filed incorrect tax returns. The taxpayers stated to the Inland Revenue Department that the company maintained proper and correct accounts. However, they did not produce any such accounts.

**Appeal dismissed.**

Ng Hu Mei Yu for the Commissioner of Inland Revenue.

Taxpayer in person.

**Decision:**

This is an appeal by two Taxpayers against certain penalty tax assessments imposed upon them under section 82A of the Inland Revenue Ordinance (the IRO). The penalties were assessed on the husband for submitting incorrect salaries tax returns for the years of assessment 1987/88 and 1988/89 and on the wife for failing to inform the

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Commissioner of her chargeability to salaries tax for the years of assessment 1989/90 to 1991/92 inclusive. The facts are as follows:

1. The Taxpayers are husband and wife. They were the owners and directors of ABC Limited (the Company) at the material time. The wife owned 95% of the shares of the Company and the husband owned 5%. The Company commenced business in 1981 and dealt solely in plastic housewares. The Company ceased business in 1993.
2. The profits tax returns of the Company for the years of assessment 1987/88 to 1991/92 showed the following particulars:

Year of Assessment	Basic Period	Turnover \$	Assessable Profits/(Loss) \$
1987/88	year ended 31-12-1987	3,073,616	26,160
1988/89	year ended 31-12-1988	3,750,690	20,430
1989/90	year ended 31-12-1989	8,613,255	51,748
1990/91	period ended 31-3-1991	11,139,077	(29,391)
1991/92	Year ended 31-3-1992	10,051,519	(23,014)

3. The husband applied for personal assessment for the year of assessment 1987/88 and filed personal assessment return which showed the following particulars:

Source	Amount \$
Property income	18,320
Salary income from ABC Ltd:	
- Self	30,000
- Wife	26,000
Wife's income from XYZ Ltd	<u>20,000</u>
	94,320
	=====

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As a result of the election of personal assessment, property tax of \$3,009 paid was refunded.

4. The assessor commenced an investigation into the tax affairs of the Taxpayers and the business operated by them. The wife attended an interview with the assessors on 7 October 1992 and disclosed, inter alia, that:
  - (a) She had been engaging in the trading of plastic products since early 70's.
  - (b) The Company was managed by her and the husband. Complete set of accounting records were kept and the husband was responsible for book-keeping.
  - (c) She set up XYZ Company Limited with the husband and their five children in 1980 for estate planning. This company was closed in 1988.
  - (d) She employed two Filipinos as domestic servants. Wages of the domestic servants, management fee and other domestic expenses such as electricity, telephone, water, were paid by the Company.
  - (e) She has five children and three of them lived overseas. Her children sometimes gave her money when they came to Hong Kong. She estimated that the amount of money received was about \$70,000 – 80,000.
  - (f) She seldom deposited money in the bank accounts but instead invested her money in diamonds and placed them in the safe box in the bank. She also used to hide the money in her home. She gradually deposited the money back into the bank accounts.
  - (g) She sold some jade to her friends from Asia for \$220,000 in 1989. Besides that, no other jewellery was purchased or sold after 1986.
  - (h) The husband inherited some antiques from his father but she told the assessors that they did not purchase or sell antiques after 1986.
  - (i) Her parents-in-law gave her \$500,000 after they disposed of two buildings at Street A and Street B in 70's. She did not receive any other gift/legacy after 1986.
  - (j) She sometimes stayed behind for vacation after business trips overseas. She was asked to review the accounts of the Company if part of the overseas travelling expenses were expended for the directors' personal use.

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- (k) The wife was informed of the penalty provisions of the Ordinance.
- 5. By a separate letter dated 28 October 1992, the assessor requested the wife to supply further information, including the books of accounts of the Company.
- 6. The wife did not reply the assessor's letter dated 28 October 1992 and the assessor issued a reminder on 4 December 1992.
- 7. By a letter dated 8 December 1992, the assessor invited the husband to call for an interview.
- 8. Having failed to receive the wife's response to the reminder on 4 December 1992, the assessor phoned the wife on 19 February 1993. The wife promised that she would send in replies by the end of March 1993. She also told the assessor that the husband was having a heart disease and would have a medical treatment in hospital in March 1993.
- 9. Despite the promise during the telephone conversation on 19 February 1993, the assessor did not receive the wife's replies to the letters dated 28 October 1992 at the end of March 1993.
- 10. On 5 November 1993, the husband attended an interview with the assessors. During the interview, the husband disclosed, inter alia, that:
  - (a) He prepared the accounting records of the Company and the books were passed to the certified public accountants for the preparation of financial statements. He was not sure whether complete set of books were kept as only simple records were kept.
  - (b) He and the wife each received a few thousand dollars as directors fee from the Company each month.
  - (c) He purchased a second hand Benz which was manufactured in 1981 at \$60,000 from his friend two/three years before. The purchase consideration was paid in cash. He did not remember if the car was registered in the name of the wife or the Company.
  - (d) He and the wife received legacy when his father died in the 60's. He did not know the amount received by the wife. His father once gave the wife \$500,000 after the disposing of the premises at Street C in the 50's. No gift or legacy was received by them after 1986.
  - (e) He received about \$1,000 from his children each month.

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A copy of the Note of Interview was sent to the husband for confirmation or comment under cover of the assessor's letter dated 9 November 1993. The husband did not respond to the assessor's letter dated 9 November 1993.

11. On 6 November 1993, the assessor telephoned the wife to follow up the letters dated 28 October 1992.
12. By letter dated 20 November 1993, the wife informed that the Company ceased business in October 1993 and provided a reply to the assessor's letter dated 28 October 1992 claiming, inter alia, that:
  - (a) She possessed a large amount of cash, jewellery and antiques before 1 April 1986.
  - (b) She sold large quantity of jewellery and antiques to tourists from Asia in cash from 1989 to 1991. The total sales proceed received was \$1,140,000.

The wife did not provide any evidence in support of her claims as requested by the assessor in the letter dated 28 October 1992. No books of the Company were supplied except some sales invoices, order forms and bank receipts.

13. The assessor was of the opinion that the known sources of income were insufficient to finance the Taxpayer's assets and family living expenses and had since been obtaining information to compile an assets betterment statement (ABS) for the Taxpayers.
14. The wife attended an interview with the assessors on 14 January 1994. The assessors informed that ABS approach would be adopted to quantify the amount of the understatement in the case and explained the rationale of the ABS as a means to quantify the quantum of understatement. A draft ABS was discussed and a list of unidentified bank withdrawals was given to the wife for clarification. The wife also gave the assessors her comments on the Note of the Interview on 7 October 1992.
15. On 16 February 1994, the assessor issued the following estimated assessments for the year of assessment 1987/88:

### Salaries tax – The Husband

Estimated Assessable Income	\$576,000
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### Profits Tax – ABC Ltd

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Estimated Assessable Profits	\$500,000 =====
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### Profits Tax – XYZ Company Ltd

Estimated Additional Assessable Profits	\$100,000 =====
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Valid objections were lodged against the above assessments.

16. On 15 March 1994, the wife attended another interview with the assessors. The following matters were discussed during the interview:

- (a) The wife could not produce any documentary evidence for the disposal of the jewellery and antiques. She used part of the sale proceeds for the daily expenses and the remaining portion was kept in the safe in her home. She reiterated that she deposited most of the cash in the bank after her husband ended a relationship with a woman in 1989. The assessor told the wife that according to the bank information, only a cheque deposit of \$193,400 was identified as sale proceeds of jewellery/gold and not much round sum cash deposits were put in her bank accounts and business bank accounts during the period.
- (b) The assessor estimated the living expenses for 1986/87 – 1991/92 at \$900,000. The wife opined that the estimation was on the high side and claimed that nearly all the private expenses were met by the contribution from her children. The money was received in cash and no documentary evidence was provided.

17. In March 1994, the husband filed salaries tax returns for the years of assessment 1987/88 to 1991/92 which showed the following particulars:

Year of Assessment	Source	Amount \$
1987/88	Self – ABC Ltd	30,000
	Wife – ABC Ltd	26,000
	XYZ Co Ltd	<u>20,000</u>
		76,000 =====
1988/89	Self – ABC Ltd	35,000

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	Wife – ABC Ltd	35,000
		70,000
		=====
1989/90		Nil
		==
1990/91		Nil
		==
1991/92		Nil
		==

The husband and the wife elected separate assessment for the year of assessment 1988/89 and joint assessment for the years of assessment 1989/90 to 1991/92.

18. On 31 March 1994, the wife filed salaries tax returns for the years of assessment 1989/90 to 1991/92 which showed the following particulars:

Year of Assessment	Source	Amount \$
1989/90	ABC Ltd	35,000
1990/91		Nil
		==
1991/92		Nil
		==

19. Having failed to receive the wife's response to the matters discussed in the meeting on 15 March 1994, the assessor telephoned the wife on 7 July 1994 and 23 September 1994, and was given to understand that the Taxpayers were not in Hong Kong from 9 July 1994 to 2 October 1994.
20. On 1 November 1994, the wife attended an interview with the assessors and the assets position of the Taxpayers were further discussed. During the interview, the wife stated that the sole supplier of the Company set up its own showroom in 1993 and sold the plastic products directly to customers. The business of the Company was greatly jeopardized and the Company ceased its operation in October 1993. The wife said she would discuss with the husband for a proposal

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to settle the investigation at a total understatement of \$1,400,000. The wife was reminded of the penalty provisions of the IRO.

21. On 7 November 1994, the wife telephoned the assessor and proposed to settle the investigation at a total understatement of \$1,400,000 for the five years ended 31 March 1992.
22. On 16 November 1994, the husband and the wife attended an interview with the assessors and confirmed the following agreements to settle the investigation:

**The Husband**

Year of Assessment	Total Assessable Income \$	Income reported/Assessed \$	(Revised)/Additional Assessable Income \$
1987/88	116,000	76,000	40,000
1988/89	<u>190,000</u>	<u>70,000</u>	<u>120,000</u>
Total	306,000 =====	146,000 =====	160,000 =====

**The Wife**

Year of Assessment	Total Assessable Income \$	Income reported/Assessed \$	(Revised)/Additional Assessable Income \$
1989/90	300,000	Nil	300,000
1990/91	520,000	Nil	520,000
1991/92	<u>420,000</u>	<u>Nil</u>	<u>420,000</u>
Total	1,240,000 =====	Nil ==	1,240,000 =====



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The assessors reminded the Taxpayers of the penal provisions of the IRO which prescribes that the maximum amount of penalties is three times of the tax undercharged.

23. Revised salaries tax assessment for the years of assessment 1987/88 and salaries tax assessments for the years of assessment 1988/89 to 1991/92 in accordance with the agreement were issued to the husband and the wife on 31 March 1995.
24. By a letter dated 30 April 1995, the Taxpayers claimed child allowance for the year of assessment 1989/90 in respect of their sons. They also requested the assessors to waive penalty or to provide a copy of the detailed statement showing how the additional incomes for the years of assessment 1987/88 to 1991/92 were arrived at.
25. In response to the Taxpayers' letter dated 30 April 1995, the assessor phoned the wife on 4 May 1995 and explained that the agreements were a result of compromise. The assessor invited the wife to lodge objections if she wished to dispute the assessments. In respect of the claim for child allowance, the assessor advised that the claim would be considered if evidence was submitted to prove that the child was receiving full time education during the relevant year. The wife said she did not disagree with the assessments.
26. The following is a comparative table of the Taxpayers' income before and after investigation and the amount of tax undercharged in consequence of the submission of incorrect returns for the years of assessment 1987/88 and 1988/89 and the failure to inform chargeability for the years of assessment 1989/90 to 1991/92:

### The Husband – Salaries Tax

Year of Assessment	Income before Investigation \$	Income after Investigation \$	Income Understated \$	Tax Undercharged \$
1987/88	76,000	116,000	40,000	3,862
1988/89	<u>70,000</u>	<u>190,000</u>	<u>120,000</u>	<u>14,720</u>
Total	146,000 =====	306,000 =====	160,000 =====	18,582 =====

The percentage of income understated to total income assessed after investigation is 52.29%. The tax undercharged for the year of assessment was

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computed under personal assessment to give effect to the husband's election of personal assessment for that year.

**The Wife – Salaries Tax**

Year of Assessment	Income before Investigation \$	Income after Investigation \$	Income Understated \$	Tax Undercharged \$
1988/89	0	420,000	420,000	63,000
1989/90	0	300,000	300,000	42,400
1990/91	<u>0</u>	<u>520,000</u>	<u>520,000</u>	<u>95,436</u>
Total	0 =	1,240,000 =====	1,240,000 =====	200,836 =====

The percentage of income understated to total income assessed after investigation is 100%.

27. By notices dated 5 May 1995, the Commissioner of Inland Revenue (the Commissioner) informed the Taxpayers that he proposed to assess the Taxpayers to additional tax in respect of the years of assessment 1987/88 to 1991/92 and invited the Taxpayers to make representations.
28. By a letter dated 5 June 1995, the Taxpayer submitted written representations to the Commissioner pursuant to section 82A(a)(iii).
29. Having regard to the documentary evidence for the claim of child allowance for the year of assessment 1989/90 supplied in the representations, the assessor revised the salaries tax assessment for the year of assessment 1989/90 on 27 June 1995 and the amount of tax involved for the year of assessment 1989/90 was reduced to \$39,150.
30. By a letter dated 30 June 1995, the assessor informed the wife that the representations would be submitted to the Commissioner to consider penalty and the Commissioner would take into account that the tax undercharged for the year of assessment 1989/90 had been reduced to \$39,150.
31. Having considered and taken into account the Taxpayers' representations, the Commissioner issued notices of assessment and demand for additional tax under section 82A for the years of assessment 1987/88 to 1991/92 to the

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Taxpayers on 19 July 1995. The following is a summary of the amounts of additional tax assessed:

**The Husband**

Year of Assessment	Tax Undercharged \$	Section 82A Additional Tax \$	Additional Tax as percentage of Tax Undercharged \$
1987/88	3,862	4,900	126%
1988/89	<u>14,720</u>	<u>18,800</u>	127%
Total	18,582 =====	23,700 =====	127%

**The Wife**

Year of Assessment	Tax Undercharged \$	Section 82A Additional Tax \$	Additional Tax as percentage of Tax Undercharged \$
1989/90	39,150	48,400	123%
1990/91	95,436	110,500	115%
191/92	<u>63,000</u>	<u>68,400</u>	108%
Total	197,586 =====	227,300 =====	115%

32. By a letter dated 18 August 1995, the Taxpayers gave notice of appeal to the Board of Review against the above assessments to additional tax.

At the hearing of the appeal the wife duly appeared before the Board and represented herself and her husband. She submitted that every year she and her husband had made correct returns and had not understated the tax. She said that the Inland Revenue Department had only estimated the income. She said that she and her husband had been very cooperative in supplying information. Because there had been no understatement of any tax she and her husband should not be subject to any penalties.

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After referring to the health of herself and her husband she continued to say that she and her husband had been cooperative in the enquiry. She said that no employ an accounting firm would have cost very high fees. Furthermore the accountant could not guarantee the success of her case. For these reasons she and her husband had decided to compromise the matter with the Inland Revenue Department. In support of the claim that the wife had inherited property and had valuable jewellery, she produced before the Board a number of what appeared to be valuable articles of jewellery.

The representative for the Commissioner submitted that the Taxpayers had not been cooperative in the course of the enquiry. She said that they had not produced the accounts for the company which they were running. However they had confirmed to the Inland Revenue Department that they had kept proper accounts. The result was that the Inland Revenue Department had to spend much time investigating the affairs of the Taxpayers. She said that the Taxpayers were not unsophisticated persons. She said that it appeared that the Taxpayers had engaged in trade for a long time operating a business under a corporate veil. The business operated by the Taxpayers was substantial and in the circumstances of the case a penalty of substantially more than 100% of the tax involved was justified. The penalties which had been imposed were only 116% of the tax undercharged which was lenient in the circumstances.

We have carefully considered the facts of this case and the submissions made before us. We do not consider the penalties imposed to be excessive. It is quite clear that the Taxpayers filed incorrect tax returns. The wife who appeared before us spent much time telling us that she and her husband had filed correct tax returns. This we find to be untrue. As a result of the investigation, the Taxpayers agreed with the Inland Revenue Department to compromise the matter on the basis that there had been a total understatement of income amounting to \$1,400,000. It would appear that during the course of the investigation the Taxpayers were not cooperative. They stated to the Inland Revenue Department that the Company maintained proper and correct accounts. However they failed to produce any such accounts. Either they deliberately told the Inland Revenue Department something which was not true or they deliberately concealed the true accounts. No doubt if they had kept true and correct accounts they would have filed accurate tax returns and this matter would never have arisen. The Taxpayers have only themselves to blame.

The facts of this case are more serious than many cases which have come before the Board of Review and merit penalties in excess of the norm of 100% of the tax undercharged. The penalties imposed vary from 108% to 127% and come to a total of approximately 116%. We do not find such penalties to be excessive in the circumstances and dismiss this appeal.