# Case No. D4/06

**Penalty tax** – incorrect tax return – reasonable excuse – excessive assessment – co-operation – Inland Revenue Ordinance ('IRO') sections 70 and 82.

Panel: Kenneth Kwok Hing Wai SC (chairman), David Li Ka Fai and Horace Wong Ho Ming.

Date of hearing: 25 February 2006.
Date of decision: 10 April 2006.

The appellant filed tax returns for the years of assessment 2000/01 and 2001/02. Further assessments were later made by the Commissioner on the ground that she did not report her salary income from a bank. They were agreed by the appellant. As a result, additional tax was assessed in the total $43,000.

The appellant explained that she did not file incorrect tax returns as she was compelled by the bank to contract as a contractor instead of an employee. Thus, she did not report her fees as her salary income.

The appellant was co-operative in concluding the compromise agreement at the first interview.

**Held:**

1. The further assessments were final and conclusive as the appellant did not object against them. Thus, she filed incorrect tax returns.

2. The appellant did not make out that she was compelled by the bank to contract as a contractor instead of an employee. There was no reasonable excuse.

3. As the appellant was co-operative, the Board found the assessments excessive and would reduce them to the total of $21,500. (D90/01 followed)

**Appeal allowed in part.**

Cases referred to:

D96/97, IRBRD, vol 12, 520
D118/02, IRBRD, vol 18, 90
D53/88, IRBRD, vol 4, 10
D78/02, IRBRD, vol 17, 978
D22/02, IRBRD, vol 17, 515
D9/05, IRBRD, vol 20, 272
D90/01, IRBRD, vol 16, 757
BR80/76, IRBRD, vol 1, 259
D18/91, IRBRD, vol 6, 36

Taxpayer in person.
Leung Wing Chau, To Yee Man and Law Pui Wah for the Commissioner of Inland Revenue.

**Decision:**

1. This is an appeal against two assessments ('the Penalty Assessments'), both dated 29 July 2005, by the Deputy Commissioner of Inland Revenue, assessing the appellant to additional tax under section 82A of the Inland Revenue Ordinance, Chapter 112, in the following sums:

| Year of assessment | Additional tax | Charge no |
|---|---|---|
| 2000/01 | $25,000 | 9-2319556-01-3 |
| 2001/02 | $18,000 | 9-3563763-02-3 |
| Total: | $43,000 | |

2. The relevant provision is section 82A(1)(a) of the Ordinance for making an incorrect return by omitting or understating income.

***The relevant facts***

3. The appellant is a computer systems specialist.

4. By an application dated 23 June 2000, she applied for business registration as sole proprietress of a business ('the Firm').

5. She signed a document called 'Professional Services Contract General Agreement' dated 23 June 2000 in the name of the Firm with a bank ('the Bank'). Under the document, the Firm would provide services in the capacity of a Systems Specialist for a term slightly in excess of one year (17 July 2000 to 31 July 2001) for the total fee of $547,560. The document further provided that the Firm would assign the appellant to provide the services.

6. On 4 October 2000, the Business Registration records of the Firm were changed in that the appellant's father ('the Father'), then unemployed, was reportedly added as a partner of the Firm with effect from 1 September 2000.

7. Subject to the following exception, the appellant reported her income as salary income for the years of assessments from 1998/99 to 2002/03:

> Exception
> In her Tax Returns – Individuals for the two relevant years of assessments, i.e. 2000/01 and 2001/02 ("the Returns"), the appellant did not report the fees paid by the Bank as salary income but reported income as a partner of the Firm with a 10% share of the profits. The Father was said to have a 90% share of the profits.

8. By letter dated 21 January 2005, the assessor informed the appellant that the Inland Revenue Department was conducting an audit of her tax returns for six years of assessment, that is, from 1998/99 to 2003/04.

9. By a bi-lingual document in Chinese and English, entitled 'Salaries Tax' dated 26 February 2005 signed by the appellant, the appellant stated that:

> '1. I hereby agree that my assessable income be computed as follows and I understand that by compromising and by not objecting to the assessments to be issued pursuant to the compromise, the assessments shall become final and clnclusive (*sic*) under section 70 of the Inlnad (*sic*) Revenue Ordinance (the Ordinance). It is established law that the Board of Review had no authority to disturb assessments which are final and conclusive:

| Year of Assessment | Assessable Income already reported/assessed | Agreed Assessable Income | Understated Assessable Income |
|---|---|---|---|
| | $ | $ | $ |
| 2000/2001 | 84,561 | 436,911 | 352,350 |
| 2001/2002 | 300,579 | 486,069 | 185,490 |
| Total | 385,140 | 922,980 | 537,840 |

> 2. I also understand that acceptance of the above-mentioned assessable income does not conclude the whole matter and that the case will be put up to the Commissioner or Deputy Commissioner for consideration of penal actions under Part XIV of the Inland Revenue Ordinance, which include prosecution, compounding or imposition of Additional Tax. If Additional Tax is imposed, the maximum amount could be treble the amount of the tax undercharged which would be premised on the entire amount of understatement

3. I also understand that I have the right to seek independent professional advice before signing the agreement'

10. The understated assessable income was computed on the basis that the fees paid by the Bank were the appellant's salary income.

11. By two additional assessments both dated 31 March 2005 ('the Further Assessments'), the assessor assessed the appellant's income in accordance with paragraph 1 of the document dated 26 February 2005.

12. The appellant did not object against any of the Further Assessments.

13. After considering the appellant's representations, the Deputy Commissioner issued the Penalty Assessments.

***The appeal hearing***

14. The appellant appealed on the grounds that she was not liable to additional tax and that the amount of additional tax was excessive having regard to the circumstances.

15. The appellant appeared in person. The respondent was represented by Mr Leung Wing-chau.

16. The appellant gave evidence on oath but did not call any other witness. The respondent did not call any witness.

17. Mr Leung Wing-chau cited the following Board of Review decisions in his bundle of authorities:

(a) D96/97, IRBRD, vol 12, 520;

(b) D118/02, IRBRD, vol 18, 90;

(c) D53/88, IRBRD, vol 4, 10;

(d) D78/02, IRBRD, vol 17, 978;

(e) D22/02, IRBRD, vol 17, 515; and

(f) D9/05, (2005-06) IRBRD, vol 20, 272.

***THE BOARD'S DECISION***

***Onus of proof***

18. Section 68(4) of the Ordinance provides that the onus of proving that the assessment appealed against is excessive or incorrect shall lie on the appellant.

***Whether returns incorrect***

19. The document dated 26 February 2005 contained clear and unequivocal warnings to the appellant about the effect of the agreement which she was considering entering into. The appellant wrote down her name in English and signed in her English name.

20. Section 70 provides that:

> *'Where no valid objection ... has been lodged within the time limited by this Part against an assessment as regards the amount of the assessable income ... assessed thereby ... the assessment as made ... shall be final and conclusive for all purposes of this Ordinance as regards the amount of such assessable income ...'*

21. Since the appellant has not objected against any of the Further Assessments, the Further Assessments have become final and conclusive for all purposes of the Ordinance as regards the amount of such assessable income. It is not open to the appellant to argue that the fees paid by the Bank were not her salary income. The Returns, completed on the footing that the fees paid by the Bank were fees paid to the Firm, were incorrect.

***Whether reasonable excuse***

22. Liability to be assessed penalty tax is not a strict liability. A taxpayer is only liable if he/she does not have reasonable excuse. Section 82A(1)(a) provides that:

> *'Any person who without reasonable excuse ... 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 ... 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 ...'*

23. D90/01, IRBRD, vol 16, 757, was a decision of a panel chaired by Mr Kenneth Kwok Hing-wai, SC. At paragraph 26, the Board questioned whether it would help to bring in the

' reasonable person' in construing 'reasonable excuse' and stated that what one is concerned with under section 82A is ' reasonable excuse' for what would otherwise be a wrongful act or omission.

24. In BR80/76, IRBRD, vol 1, 259 at pages 261 - 262, a panel chaired by Mr L J D' Almada Remedios held on the facts of that case that:

> *'If the Appellant honestly believed that the sales were capital transactions this would amount to reasonable excuse since returns need not include profits or losses in transactions involving capital assets. The Appellant does not understand accounts and he employs professional accountants to advise and deal with these matters. It would seem to us that reliance on the advice of an expert could also amount to reasonable excuse within the meaning of the section.*
>
> *Finding as we do that when the returns were filed neither the Appellant nor his accountant believed that these transactions were trading transactions and that this belief was honestly entertained (whether rightly or wrongly) a penalty assessment does not become exigible for reasons which we have stated.'*

25. D18/91, IRBRD, vol 6, 36, was a case where the taxpayer did not report the gains from the disposal of property. The Board (a panel chaired by Mr Denis Chang QC) held at pages 40 – 41 that:

> *(a) the fact that a taxpayer was assisted by professional advisers could sometimes make it more difficult for the taxpayer to put forward any reasonable excuse for not having made a correct return;*
>
> *(b) the taxpayer acted on professional advice throughout and reasonably left the manner and form of the return to the professional advisers who acted honestly and reasonably throughout with no intention to withhold any requisite supporting information;*
>
> *(c) everything depended on the facts of each case; and*
>
> *(d) in all the circumstances of the case there was reasonable excuse within the meaning of section 82A of the Ordinance.*

26. In this appeal, the appellant' s case was that:

> (a) she was compelled by the Bank to contract as a contractor instead of an employee;

(b) to her, it was a case of the Bank dealing with the Firm and she had reported the fees paid by the Bank under profits tax;

(c) she did not know that she should report the fees as her salary.

27. It is an unfortunate fact of life that oral evidence adduced by some of the appellants who appear in person is not quite to the point, with gaps here and there. It is even more unfortunate when an appeal turns on the facts in that case and the cross-examination by some assessors is ineffective, irrelevant and unhelpful.

28. The appellant told us that there were about 30 persons in her team and that about seven to eight of them had contracts similar to hers. Since more than two thirds of the persons in her team were employees, the appellant had failed to make out the factual basis of her case that she was compelled by the Bank to contract as a contractor instead of an employee.

29. In the absence of compulsion by the Bank, the appellant has failed to satisfy us on a balance of probabilities that any belief which she might have that the fees paid by the Bank were not salary income was honestly or reasonably held.

30. We do not think the appellant has made out any reasonable excuse.

***Whether excessive in the circumstances***

31. The Penalty Assessments average 68% of the tax involved (72% for the 2000/01 year of assessment and 64% for the 2001/02 year of assessment).

32. For the year of assessment 2000/01, the appellant understated 81% of the correct amount of income. For 2001/02, the understatement was 38%.

33. The Inland Revenue Department audited the appellant's tax returns for six years of assessment. The understatement, although involving two years of assessment, was in respect of the fees from the Bank over a one-year period.

34. We are most impressed by the appellant's co-operation. She concluded the compromise agreement at the first interview, which took place one month and five days after the date of the letter from the assessor informing her of the audit. Her co-operation would have been even more helpful in mitigation had she not tried to re-open the salary/profits issue. To her credit, she did not press this point when the clear and unequivocal wording of the 26 February 2005 document was drawn to her attention.

35. In D90/01, the taxpayer understated 17.26% of the correct amount of profits over a 6-year period and was assessed to penalty tax at 67.78% of the amount of tax involved over the

6-year period. Five months and one day after a query letter, the taxpayer and the Commissioner agreed the revised profits for six years of assessment. The Board was impressed by the co-operation of the taxpayer and reduced the penalty assessments by half:

> '*46. In our decision, the Assessments (67.78%) are excessive in the circumstances of this case.*
>
> *47. There must be a real difference in penalty between those who mitigate their breaches by being co-operative and those who aggravate their breaches by being obstructive.*
>
> *48. None of the cases cited by the parties assists us on the appropriate quantum given the impressive co-operation by the Appellant.*
>
> *49. In answer to a question from the chairman, Mr Wong Yun-tung suggested reducing the Assessments by half.*
>
> *50. In the absence of any assistance by either party on the appropriate amount of penalty and in the absence of any guidance by any previous Board of Review decision, we do not think the suggested 33.89% is unreasonable.'*

36. We agree that there must be a real difference in penalty between those who mitigate their breaches by being co-operative and those who aggravate their breaches by being obstructive. In our Decision, the Penalty Assessments are excessive in the circumstances of the case. In the absence of any assistance by either party on the appropriate amount of penalty, we adopt the same approach as the Board did in D90/01.

***Disposition***

37. This appeal is allowed in part and we reduce the Penalty Assessments as follows:

| Year of assessment | Charge number | Additional tax | **Reduced by the Board to** |
|---|---|---|---|
| | | $ | **$** |
| 2000/01 | 9-2319556-01-3 | 25,000 | **12,500** |
| 2001/02 | 9-3563763-02-3 | 18,000 | **9,000** |
| | Total: | 43,000 | **21,500** |