Case No. D41/04

Penalty tax – attempt to vary settlement agreement – whether quantum excessive – co-operation.

Panel: Ronny Wong Fook Hum SC (chairman), Jiang Zhaodong and Lily Yew.

Date of hearing: 24 July 2004.
Date of decision: 8 September 2004.

In June 1999, the Revenue commenced investigation into the affairs of the appellant. In August 2002, the Revenue and the appellant, who was represented, entered into a settlement agreement. As a result, additional tax was imposed against the appellant.

The appellant sought to re-open the settlement agreement. Besides, he contended that the additional tax is excessive bearing in mind his co-operation with the Revenue.

Held:

1. The Board rejected the appellant's attempt to re-open the settlement agreement as he was under professional advice all along.

2. In the absence of mitigations, 100% of the tax undercharged would have been appropriate in the circumstances of this case. (D118/02; D53/88 followed). However, the Board was impressed by the degree of co-operation on the part of the appellant. The Board held that a 25% reduction would be justified and therefore the penalty tax assessed in question would be so varied.

Appeal allowed in part.

Cases referred to:

D118/02, IRBRD, vol 18, 90
D53/88, IRBRD, vol 4, 10

King Chi Hung for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

Circumstances leading to the appeal

1. The Appellant came to Hong Kong in 1973 and worked in various construction sites.

2. On 1 August 1981, the Appellant registered as sole proprietor a business in the name of Company A. The business of Company A ceased on 31 March 2000.

3. On 30 October 1990, the Appellant incorporated a company in the name of Company B. At all material times, the Appellant was a director and controlling shareholder of Company B.

4. Both Company A and Company B carried on plumbing and other building construction business. They tendered for work in various Government projects.

5. The Revenue commenced investigation into the affairs of the Appellant on 4 June 1999. The Appellant attended his first interview with the Revenue on 4 June 1999. The Appellant had by then engaged the First Representative to advise him in connection with the investigation. The Appellant attended further interviews and provided various documents and information as requested by the Revenue. The parties agreed that the Appellant should prepare an asset betterment statement in order to assess his fiscal position.

6. On 6 September 2001, the First Representative submitted an assets betterment statement to the Revenue. Further discussions took place between the parties as to the implications of this statement.

7. The Appellant appointed the Second Representative as his new adviser on 22 November 2001. The Second Representative put forward proposals on 15 August 2002 for settling with the Revenue. The parties concluded a settlement agreement on 21 August 2002. As a result of the settlement the fiscal positions of Company A and the Appellant are as follows:

(a) Company A

Year of assessment	Assessable profits after investigation	Assessable profits before investigation	Profits understated	Tax undercharged
1993/94	$3,178,390	$178,390	$3,000,000	$450,000
1997/98	$38,671	$0	$38,671	$5,220

	$3,217,061	$178,390	$3,038,671	$455,220

(b) The Appellant

Year of assessment	Assessable profits after investigation	Assessable profits before investigation	Profits understated	Tax undercharged
1994/95	$3,734,000	$1,984,000	$1,750,000	$262,500
1995/96	$2,908,300	$1,158,300	$1,750,000	$262,500
1996/97	$3,771,800	$2,021,800	$1,750,000	$262,500
1997/98	$2,322,000	$0	$2,322,000	$313,470
	$12,736,100	$5,164,100	$7,572,000	$1,100,970

8. By notice dated 22 December 2003, the Commissioner informed the Appellant of her intention to impose additional tax against the Appellant under section 82A(4) of the Inland Revenue Ordinance (Chapter 112) ['the IRO'] for filing incorrect returns and for failing to comply with section 51(1) of the IRO. After considering representations from the Second Representative dated 19 February 2004, the Commissioner by notices dated 25 March 2004 imposed additional tax as follows:

(a) Company A

Year of assessment	Amount of tax undercharged	Additional tax	% between additional tax and tax undercharged
1993/94	$450,000	$506,000	112.44%

(b) The Appellant

Year of assessment	Amount of tax undercharged	Additional tax	% between additional tax and tax undercharged
1994/95	$262,500	$295,000	112.38%
1995/96	$262,500	$295,000	112.38%
1996/97	$262,500	$290,000	110.47%
1997/98	$318,690**	$260,000	81.71%
	$1,106,190	$1,140,000	103.05%

** The sum of $318,690 is the sum total of $5,220 being the tax undercharged on Company A and $313,470 being the sum undercharged on the Appellant for 1997/98.

9. This is the Appellant's appeal against the additional tax imposed on him trading as Company A and on him personally.

Submissions of the Appellant

10. The Appellant sought to re-open the settlement of 21 August 2002. He submitted that the Revenue:

(a) should not have included the assets of his wife in computing his fiscal position. He separated from his wife on 1 December 1996. He had little knowledge of her financial position as they were not on good terms.

(b) should not have included various cash transactions as income of his business. He said he gambled heavily in Macau and elsewhere and he also extended numerous loans to others. All those transactions were in cash and verification could be obtained from the casinos and his debtors.

11. The Appellant further submitted that the additional tax imposed is excessive bearing in mind his co-operation with the Revenue.

Re-opening the settlement

12. We have no hesitation whatsoever in rejecting the Appellant's attempt to re-open the settlement concluded on 21 August 2002. The Appellant was advised throughout by a leading firm of professional accountants. The penalty provisions were clearly explained to him at various stages of the Revenue's investigation. There is no justification to revisit a settlement when the initial proposal emanated from the Second Representative acting on behalf of the Appellant.

Basis of the Revenue's assessment

13. Mr King (Acting Senior Assessor) in a very fair presentation of the Revenue's case informed us that the Revenue takes the view that this case falls within category (b) of the 'Failure to effect complete disclosure or delayed disclosure' grouping in the Revenue's policy statement on penalty loading. According to that statement, that category attracts penalty ranging between 110% and 150% of the tax undercharged. Mr King accepts that the Appellant had been co-operative. He said the Revenue had made a 25% allowance in the Appellant's favour on that score. Mr King pointed out that the investigation in question was lengthy and the tax in question was retained by the Appellant for a considerable period of time.

14. The level of penalty was reviewed by this Board in Case No D118/02, IRBRD, vol 18, 90. This Board approved the statement in D53/88, IRBRD, vol 4, 10 that a penalty at 100% of the amount of tax undercharged is appropriate to those cases:

(a) where there has been no criminal intent and the taxpayer has totally failed in his or its obligations under the IRO;

(b) where the Commissioner has had to resort to investigations or the preparation of assets betterment statements or has had difficulty in assessing the tax;

(c) where the failure by the taxpayer to fulfill his or its obligations under the IRO has persisted for a number of years.

15. In the absence of any mitigating factor, we are of the view that 100% of the tax undercharged would have been appropriate in the circumstances of this case. We are however impressed by the degree of co-operation on the part of the Appellant. He sought professional assistance shortly after commencement of investigation. He readily produced to the Revenue his available records. His representative prepared assets betterment statement for the Revenue's consideration. He initiated settlement discussions with the Revenue culminating in the agreement of 21 August 2002. We are of the view that these are weighty mitigating factors which justify a 25% reduction.

16. For these reasons, we allow the Appellant's appeal in part and we vary the penalty tax assessed for each year in question to 75% of the amount of tax undercharged.