

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D42/88

Penalty assessment – whether penalty excessive – statement of relevant criteria – s 82A of the Inland Revenue Ordinance.

Penalty assessment – whether taxpayer could argue that he was not liable to pay tax – ss 70 and 82A of the Inland Revenue Ordinance.

Panel: T J Gregory (chairman), Stephen Lau Man Lung and Eric Lo King Chiu.

Date of hearing: 25 August 1988.

Date of decision: 21 October 1988.

The taxpayer successfully carried on business as a fortune-teller. In his first year of business, he failed to submit a profits tax return. For the three subsequent years, he submitted returns which understated his true profits. Following investigations and negotiations, the taxpayer agreed to an assets betterment statement and was further assessed on the basis of these. He did not object to these assessments.

The Commissioner subsequently issued a penalty assessment equal to 39% of the maximum permitted.

In his appeal, the taxpayer argued that the assets betterment statement on which the further assessments and penalties were based was incorrect. The Board also considered whether the penalties were excessive.

Held:

- (a) The taxpayer could not be permitted to challenge the correctness of the assets betterment statement since this amounted to challenging the correctness of the assessments which were based on that statement. Under section 70, such assessments were final and conclusive.
- (b) In assessing penalties, relevant factors include the gravity of the case, the loss suffered by the Revenue, the co-operation given by the taxpayer, the sophistication of the taxpayer, the sophistication of the taxpayer's business and the absence of evidence that the taxpayer deliberately concealed his tax liability.

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- (c) Considering these points, the scope of the taxpayer's activities indicated that he was sophisticated. His business of fortune-telling was likewise sophisticated in that it required the taxpayer to gain customers' confidences and to speak with authority. The fact that he omitted to make a first year return and understated his profits in subsequent years at a level lower than necessary to support his assets showed that he deliberately was concealing his tax liability. Furthermore, the fact that he attempted to negotiate lower assessments than he subsequently accepted showed a lack of full co-operation.
- (d) Where a taxpayer's culpability is attributable to a lack of sophistication, the practice of the Commissioner is to assess a penalty equal to the amount of tax undercharged (that is, 33.3% of the maximum permitted). On the facts, a higher penalty (here, 39%) was not out of order.
- (e) Of interest is an admission by the Commissioner's representative that, in determining the level of penalty tax, the Commissioner included an element of compensation for lost opportunity (that is, interest) in order to reflect the number of years the unpaid tax was outstanding.

Appeal dismissed.

Cases referred to:

D10/81, IRBRD, vol 1, 404
D18/87, IRBRD, vol 2, 391
D38/87, IRBRD, vol 2, 422
D58/87, IRBRD, vol 3, 11
D63/87, IRBRD, vol 3, 55

Tse Hon Kin for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

1. THE NATURE OF THE APPEAL

The Taxpayer appealed to the Board of Review against assessments to additional tax levied by the Commissioner of Inland Revenue pursuant to section 82A of the Inland Revenue Ordinance.

2. THE FACTS

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- 2.1 On 25 February 1986, the Taxpayer was called by appointment to the Inland Revenue Department for interview into his business affairs.
- 2.2 During this interview, the Taxpayer was shown the profits tax returns for his business for the years of assessment 1982/83, 1983/84 and 1984/85. The representative of the Revenue obtained information with respect to the Taxpayer and his business, all of which is recorded in a note of interview.
- 2.3 Almost seven months subsequent to this interview, during which period the Revenue attempted to progress the compliance by the Taxpayer with the Ordinance, by letter dated 21 July 1986, a firm of certified public accountants submitted on behalf of the Taxpayer a 'Head-and-tail' assets betterment statement. Later in the year, an assets betterment statement dated 28 November 1986 was sent by the Revenue to the Taxpayer and on 9 January 1987 the tax representatives of the Taxpayer submitted a revised assets betterment statement with an offer of an admission of a total discrepancy of \$500,000 to resolve the matter.
- 2.4 After further correspondence, a further interview took place on 12 March 1987. A note of interview was recorded.
- 2.5 After further correspondence, on 9 June 1987 the Taxpayer and his tax representative attended at the offices of the Revenue by prior appointment, signed the revised assets betterment statement for the period 31 March 1981 to 31 March 1985 ('the ABS'). He was first warned that penal action was within the personal prerogative of the Commissioner of Inland Revenue or his deputy, and that maximum penalty by way of additional tax could be three times the tax under-charged.
- 2.6 By registered letter dated 7 December 1987, the Deputy Commissioner of Inland Revenue notified the Taxpayer that it was proposed to assess additional tax under section 82A and invited the Taxpayer to submit written representations which could be considered and taken into account before any assessments of additional tax were made. A letter dated 9 December 1987 was delivered by the Taxpayer to the Revenue and thereafter, on 11 January 1988, notices of assessment and demands for additional tax under section 82A of the Ordinance were raised as follows:

<u>Year of Assessment</u>	<u>Section 82A Additional Tax</u>
	\$
1981/82	12,400
1982/83	53,600
1983/84	49,700
1984/85	42,600

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- 2.7 On 18 January 1988, the Taxpayer filed a letter with the Clerk to the Board of Review setting out twelve reasons which the Board treated as the Taxpayer's grounds of appeal.

3. DOCUMENTATION

The Board had before it the following documents:

- 3.1 A statement of facts dated 19 July 1988 prepared by the Revenue.
- 3.2 A copy of the profits tax return of the Taxpayer for the year of assessment 1982/83.
- 3.3 A copy of the profits tax return of the Taxpayer for the year of assessment 1983/84.
- 3.4 A copy of the profits tax return of the Taxpayer for the year of assessment 1984/85.
- 3.5 A copy of the profits tax return of the Taxpayer for the year of assessment 1985/86.
- 3.6 Letter from the Revenue to the Taxpayer dated 10 March 1986 with a copy of the note of the interview of 25 February 1986 referred to in paragraph 2.2.
- 3.7 Letter dated 21 July 1986 from the Taxpayer's tax representatives to the Revenue with the 'Head-and-Tail' assets betterment statement referred to in paragraph 2.3 above.
- 3.8 The letter of 28 November 1986 from the Revenue to the Taxpayer enclosing the assets betterment statement referred to in paragraph 2.3 above.
- 3.9 Letter dated 9 January 1987 from the Taxpayer's tax representatives, together with a proposed assets betterment statement.
- 3.10 Letter from the Taxpayer's tax representatives dated 24 February 1987.
- 3.11 Note of interview with the Taxpayer dated 12 March 1987.
- 3.12 Profits tax return for the year of assessment 1981/82.
- 3.13 Letter from the Taxpayer's tax representatives dated 17 March 1987 with revised assets betterment statement.

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- 3.14 Letter of 11 June 1987 from the Revenue to the Taxpayer enclosing notes of the interview of 9 June 1987.
- 3.15 Copy of letter from the Revenue to the Taxpayer dated 7 December 1987, referred to in paragraph 2.6 above.
- 3.16 Taxpayer's representatives of 9 December 1987 (in Chinese with translation), referred to in paragraph 2.6 above.
- 3.17 The Taxpayer's grounds of appeal.
- 3.18 Notices of assessment to additional tax under section 82A of the Ordinance dated 11 January 1988 in respect of the years of assessment 1981/82, 1982/83, 1983/84 and 1984/85.

4. THE MATTER IN ISSUE ON THE APPEAL

- 4.1 The Taxpayer's appeal is against the additional assessments.
- 4.2 Taxpayer's Submissions
 - 4.2.1 At the hearing, the Taxpayer was advised by the Board as to the nature of his appeal, namely, that it was his duty to bring to the Board's attention factors which he considered should be taken into account by the Board in considering whether the amounts of the additional tax assessed were proper. The Taxpayer was afforded the opportunity to address the panel or give evidence on oath. He enquired as to the difference and was advised by the Chairman that, if he were to address the panel on oath, he would be subject to questioning by the representative of the Revenue and, if it was subsequently ascertained that he had told untruths, he was at risk of being charged with perjury. It was eventually agreed that the Taxpayer would make a statement but would be sworn if, in his statement, he introduced any matters in the nature of evidence which the Board considered should be on oath.
 - 4.2.2 The Taxpayer's submissions were essentially restricted to criticisms of the ABS. Essentially, his criticisms were that the ABS was overstated because loans which the Taxpayer submitted he had received had not been allowed.
 - 4.2.3 The Taxpayer insisted that his acceptance of the ABS was not because he was satisfied it was accurate, but because of the health of an uncle who had lent him money and who was in no fit condition to attend the Revenue to be interviewed, and to avoid further upsetting his mother who had been angered by the investigation.

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- 4.2.4 The Taxpayer stated that, if he had not agreed to accept the ABS he had been told that the Revenue would continue its investigations. He stated that he had agreed to sign the ABS to avoid this as further investigations could have been a disturbance to his uncle.
- 4.2.5 The Taxpayer submitted that the sum total of the penalties was excessive, without offering any reason other than his ability to pay because of the level of his current business. He stated that he could not pay it.
- 4.2.6 During the course of his submission, the Board, on more than one occasion, requested the Taxpayer to submit reasons why the Board should consider the additional assessments excessive. Unfortunately, the Taxpayer insisted on complaining as to the accuracy of the ABS and reiterating the fact that he did not wish others to be questioned. The Taxpayer made no submissions which the Board considered were relevant in considering the fairness, or otherwise, of the additional assessments.
- 4.3 Revenue Submission
- 4.3.1 The Revenue submission was in written form. The Taxpayer was given a copy which he was able to read. As the Revenue representative read out his written submission, this was translated into Cantonese for the benefit of the Taxpayer. The submission may be summarised as follows:
- 4.3.1.1 The grounds of appeal and the submissions made by the Taxpayer were no more than a recapitulation of his disagreement with the profits computed on the basis of the ABS.
- 4.3.1.2 The Taxpayer signified his agreement to the ABS in the presence of his tax representative: refer paragraph 2.5 above.
- 4.3.1.3 The Taxpayer's agreement to the ABS was made with his free deliberate decision to accept the potential for additional tax assessments.
- 4.3.1.4 The ABS had become final and conclusive under section 70 and was not capable of being reopened.
- 4.3.1.5 The Revenue referred to three previous decisions of the Board of Review including cases D10/81, D18/87 and D63/87.
- 4.3.1.6 The submission for the Revenue concluded by drawing the attention of the Board to the criteria adopted by the Commissioner when assessing penalties, including the co-operation given by the Taxpayer which, in the submission of the Revenue, was not bona fide as evidenced by the attempts on the part of the Taxpayer to negotiate an assets betterment statement lower than that

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subsequently agreed to by him. This was classified by the Revenue's representative as an incomplete offer to co-operate.

4.3.1.7 The Revenue also advised the Board that the tax assessed and the additional assessments have been discharged by the Taxpayer.

4.3.1.8 In reply to a question from the Board, the Revenue's representative stated that, in determining the amount of additional tax, the Commissioner included an element of compensation to the Revenue for lost opportunity whereby the amount of additional tax is increased to reflect the number of years the unpaid tax was outstanding.

4.4 The Taxpayer's Reply

In his reply, the Taxpayer reiterated much of the ground covered in his original submission which concentrated on his disagreement with the ABS. The Taxpayer did not challenge the validity of any of the submissions made by the Revenue or the accuracy of any fact addressed in that submission.

5. REASONS FOR DECISION

5.1 The Matter Under Appeal

The appeal was the Taxpayer's attempt to persuade the Board that the assessments to additional tax were excessive. Much of the Taxpayer's submissions related to matters which are not the subject matter of the appeal, particularly the ABS. However, section 70 of the Ordinance applies and the assessments based on the agreed ABS are final and conclusive as there was no appeal against the assessments raised on the ABS.

5.2 Authorities

5.2.1 Case D10/81

In the reasons given in this case, an appeal against assessments to additional tax, the Board stated as follows:

'In appealing against the penalty assessments the Taxpayer's contention is that full disclosure of his income had been made by him as reflected in the returns for which reasons he says he is not liable to any penalties. This contention does not hold water. The Taxpayer cannot approbate and reprobate. If a Taxpayer agrees to an assessment for tax founded on an assets betterment statement (whether original or revised) and he pays or is paying the tax so assessed he must be taken to admit that it relates to a liability to which he is chargeable to

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tax. His liability under the assessment cannot be reopened. It has become final and conclusive: section 70.'

5.2.2 Case D18/87

In a similar case the Board stated:

'Since he, the Taxpayer, has accepted the correctness of the revised ABS, the Board is of the view that it is not open to him to adopt a stand in the appeal which necessarily implies that the revised ABS was incorrect.'

5.2.3 Case D63/87

In another similar case, the Board stated:

'The Taxpayer agreed the assets betterment statement on the basis of which the Revenue assessments for 1977/78 to 1980/81 were issued. They show that the amount of tax undercharged was \$232,314. It is not open to the Taxpayer to dispute such assessments before us.'

5.2.4 The Board is satisfied that these three cases apply to this appeal.

5.3 Matters for Consideration

Case D58/87 is a relevant case in that it records the basis upon which the Commissioner assesses penalties, namely:

- 5.3.1 the gravity of the case;
- 5.3.2 the loss suffered by the Revenue;
- 5.3.3 the co-operation given by the taxpayer; and
- 5.3.4 other relevant considerations.

5.4 In case D38/87, the Chairman of that Board took the following factors into account:

- 5.4.1 the sophistication of the taxpayers;
- 5.4.2 the sophistication of the taxpayer's business;
- 5.4.3 the absence of evidence that the scheme was deliberate or designed to conceal tax;

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5.4.4 the co-operation of the taxpayers.

5.5 Application of Case D38/87 to the Taxpayer

5.5.1 The Board considered whether or not the Taxpayer was a sophisticated person. In his interview by the Revenue on 25 February 1986, the Revenue extracted personal particulars from the Taxpayer and his activities since he came to Hong Kong in 1968. Since opening his business, he had acquired a disciple, that is, a follower/trainee, he had appeared on television and on radio telling fung-shui stories, he had written articles for magazines and newspapers, he had written a few books which were published and he has given lessons on a related topic.

The Board is satisfied that the Taxpayer could not be described as an unsophisticated person.

5.5.2 The nature of the Taxpayer's business.

The Taxpayer's business is associated with the advice to his customers of their destiny and the steps they should take to improve their destiny. The Board would not categorise this as an unsophisticated business: essentially, to succeed it is necessary to obtain the confidence of customers etc and speak with authority. This requires sophistication.

The Board is satisfied that it would be incorrect to describe the Taxpayer's business as unsophisticated.

5.5.3 Absence of evidence that the scheme was deliberate or intended to conceal tax.

On the facts, the business to which the additional assessment for the year of assessment 1981/82 was assessed was simply not reported.

For the three subsequent years, the Taxpayer submitted returns and these returns clearly showed a level of turnover lower than that necessary to support his assets.

It is the opinion of the Board that the Taxpayer was endeavouring to conceal his liability to tax.

5.5.4 Co-operation of the Taxpayer.

On the facts before the Board, the Board finds it impossible to hold that the Taxpayer has fully co-operated with the Revenue. From his initial interview until his agreement to the ABS he, through his tax representatives, endeavoured to negotiate lower assessments than ultimately were accepted by him and, on his own admission, and disregarding the motives alleged by him which the

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Board does not accept as valid motives, eventually agreed to the ABS to put an end to the investigation of his affairs.

5.5.5 Are these additional assessments excessive?

An analysis of the additional assessments shows that the total tax sought to be avoided amounted to \$134,001 and that the additional assessments amount to 39% of the maximum.

Taking into consideration the fact that the years of assessment commenced in 1981 and concluded in 1985 and that the tax was not paid until 1988, the Board is not prepared to rule that the additional assessments were in any way excessive.

The Board considers it proper for the Commissioner, when considering the quantum of an additional assessment, to add to the tax an element of penalty to compensate for loss of interest.

5.5.6 A number of recent cases have been reported in which the Board has made it clear that there can be no excuse for a person either failing to make any tax returns at all or failing to notify the Commissioner of his correct taxable income. In cases in which a taxpayer's culpability can be attributed to a lack of sophistication, the practice of the Revenue in assessing penalties has been to assess an amount equal to the tax which would have been avoided if an investigation had not taken place. The Board does not consider that in this case the Commissioner was wrong in making additional assessments which are more than the total amount of the tax sought to be avoided. The Board is satisfied that the Taxpayer knew what he was doing and, throughout the investigation, attempted to negotiate a liability to tax on profits less than his actual profits.

6. DECISION

For the reasons given, the Board dismisses this appeal.