

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D43/88

Penalty assessment – general yardstick for calculation of penalties – s 82A of the Inland Revenue Ordinance.

Panel: William Turnbull (chairman), Lester Kwok Chi Hang and E M I Packwood.

Date of hearing: 21 July 1988.

Date of decision: 25 October 1988.

The taxpayer carried on business as a shopkeeper. He failed to keep proper accounts, failed to file returns in some years, and filed incorrect returns in other years. After investigation, he was assessed on the basis of an assets betterment statement. Subsequently, the Commissioner assessed the taxpayer to penalties ranging from 2.6% to 49.9% (average 16.6%) of the maxima permitted.

The taxpayer appealed, and argued that the penalties were excessive.

Held:

The penalties were not excessive.

- (a) Where fraudulent evasion is not alleged, but the taxpayer has failed to comply with his obligations and has failed to maintain proper accounting records, the starting point for penalties is the amount of tax undercharged (that is, 33.3% of the maximum permitted). This is only the starting point, since each case depends on its own facts.
- (b) The size of the penalty in terms of its monetary amount is irrelevant. The amount is proportionate to the tax undercharged.
- (c) The taxpayer was equally blameworthy in each year. The percentage of the maximum penalty should therefore be the same for each year.
- (d) On the facts, the higher penalties levied in respect of earlier years were high, but the lower penalties levied in respect of later years were light. Overall, however, the penalties were not excessive.

Appeal dismissed.

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Yeung Kwai Cheong for the Commissioner of Inland Revenue.
Taxpayer in person.

Decision:

This is an appeal by an individual who is carrying on business as a shopkeeper. He failed to fulfil his obligations under the Inland Revenue Ordinance and the Deputy Commissioner imposed upon him a number of additional penalty tax assessments under section 82A against which he has appealed to the Board of Review. The facts were as follows:

1. The Taxpayer was a shopkeeper and, in addition to a principal shop, had some five branch shops operated in different premises under various names.
2. The Taxpayer commenced business on 27 January 1979 and applied for a separate business registration for one of his branch shops in 1981.
3. The Taxpayer filed profits tax returns for the years of assessment 1980/81 and 1982/83. The profits disclosed by the Taxpayer in his tax returns were below the threshold for assessment to tax after allowance was made for his entitlement to personal allowances. Accordingly, no assessments were made against the Taxpayer for those two years.
4. In June 1985, the Inland Revenue Department interviewed the Taxpayer and conducted an investigation into his affairs. When the Taxpayer was interviewed on 14 June 1985 by the Inland Revenue Department, profits tax returns for the years of assessment 1979/80, 1981/82, and 1983/84 were given to the Taxpayer for completion. In the course of the interview, the Taxpayer asked whether or not the returns which he had made for the years 1980/81 and 1982/83 were correct and he confirmed that they were.
5. In October 1985, the Taxpayer submitted to the Inland Revenue Department the three tax returns which had been given to him on 14 June 1985 together with a revised profits tax account for the year of assessment 1982/83. These returns and revised account showed the following profits:

| <u>Year of Assessment</u> | <u>Profit/(loss) per Return/Revised Account</u> | <u>Returned Profits after Computation adjustments</u> |
|-------------------------------|---|---|
| | \$ | \$ |
| 1979/80 | (698) | 13,533 |

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| 1981/82 | 153,771 | 163,550 |
| 1982/83 | 152,155 (Revised Account) | 151,115 |
| 1983/84 | 216,329 | 224,588 |

6. The investigating officers did not accept the returns for 1979/80 to 1982/83 as being correct, because the Taxpayer had not kept complete accounting records. An assets betterment statement was prepared by the Inland Revenue Department and on 7 January 1986 assessments were issued based on the assets betterment statement as follows:

| <u>Year of Assessment</u> | <u>Assessable Profits</u> \$ |
|---------------------------|---------------------------------|
| 1979/80 | 73,231 |
| 1980/81 | 35,165 |
| 1981/82 | 173,050 |
| 1982/83 | 245,191 |
| 1983/84 | 224,588 |

7. The Deputy Commissioner was of the opinion that the Taxpayer had without reasonable excuse made incorrect profits tax returns for the years of assessment 1979/80 to 1982/83 inclusive and also had failed to inform the Commissioner in writing that he was chargeable to tax for the year of assessment 1983/84 within the period prescribed under section 51(ii) of the Inland Revenue Ordinance. On 18 February 1986, the Deputy Commissioner gave notice of his intention to assess penalty tax under section 82A of the Inland Revenue Ordinance and after considering written representations from the Taxpayer, on 7 April 1986 the Deputy Commissioner issued the following assessments for additional tax under section 82A:

| <u>Year of Assessment</u> | <u>Assessable Profits</u> \$ |
|---------------------------|---------------------------------|
| 1979/80 | 14,300 |
| 1980/81 | 1,000 |
| 1981/82 | 1,900 |

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|---------|---------------|
| 1982/83 | 21,200 |
| 1983/84 | <u>2,600</u> |
| | <u>41,000</u> |

The Taxpayer appeared before us in person and submitted that the penalty assessments were excessive in all of the circumstances. He said that he had no accounting knowledge, had lost a number of accounting records, and had been negligent. He stressed that he had not been fraudulent or attempted to evade tax or wilfully understate his taxable profits. He said that, for the two years 1980/81 and 1981/82 he had declared his taxable income to the best of his ability and pointed out that the discrepancy for those two years was small.

The Taxpayer went on to say that, in relation to 1982/83, confusion had arisen because he had opened a new branch of his business under a different name and he had thought it was necessary to obtain a separate business registration certificate for this new branch. He said that it was only after he had been interviewed by Inland Revenue Department personnel that he was aware of the fact that he was carrying on one business with many branches rather than two different businesses.

With regard to the year 1983/84, the Taxpayer said that he had returned all of the tax return forms which had been given to him by the Inland Revenue Department and he did not know the tax regulations and did not think that a penalty should be imposed upon him for his failure to notify the Commissioner with regard to his taxable income for the year of assessment 1983/84.

It is convenient to set out the additional tax imposed as a percentage of the tax undercharged in the following table:

| <u>Year of Assessment</u> | <u>Tax Undercharge</u> \$ | <u>Additional Tax Imposed</u> \$ | <u>Percentage of Penalty to Tax</u> \$ |
|-------------------------------|----------------------------------|---|---|
| 1979/80 | 9,557 | 14,300 | 149.6% |
| 1980/81 | 766 | 1,000 | 130.5% |
| 1981/82 | 1,425 | 1,900 | 133.3% |
| 1982/83 | 36,778 | 21,200 | 57.6% |
| 1983/84 | <u>33,688</u> | <u>2,600</u> | <u>7.7%</u> |

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| Total | <u>82,214</u> | <u>41,000</u> | <u>49.9%</u> |
|-------|---------------|---------------|--------------|

This appeal is one of a number of appeals which have recently come before the Board of Review in which taxpayers have asked the Board to review penalties imposed by the Commissioner or Deputy Commissioner under section 82A of the Inland Revenue Ordinance. A pattern has emerged from these other appeals. In cases where it is not alleged that a taxpayer has been fraudulent by attempting to evade payment of tax but the taxpayer has failed to comply with his obligations under the Inland Revenue Ordinance and has been found to be carrying on business without any or adequate accounting records, the starting point for assessing penalties should be one times the amount of tax undercharged. The facts of each particular case are unique and no hard and fast rule can be applied. It is necessary to study the circumstances and facts of each case separately. However there must be a starting point or yardstick and one times the tax undercharged is in our opinion appropriate for this purpose. It has also been confirmed to be appropriate in a number of other decisions of the Board of Review.

The quantum of penalties when converted into money can be substantial. This is in accordance with the provisions of the Inland Revenue Ordinance as laid down by the legislature. The legislature has provided that the public revenue should be protected and has imposed substantial maximum deterrents of up to three times the tax undercharged. Accordingly, in each case the monetary sum will vary in direct relationship to the amount of the tax undercharged.

In the appeal now before us, the Commissioner has imposed in total penalties of about 50% of the tax undercharged. This does not appear to us to be excessive. As there are five different assessments against which the Taxpayer has appealed, it is necessary for us to consider each one in turn. This we have done and, whilst it might appear to us that the penalties imposed in respect of the first three years are high, it likewise appears to us that the penalties in respect of the last two years are light. As the overall result is only 50% of the total amount of tax undercharged, we consider it inappropriate in all of the circumstances to attempt to vary any of the assessments by reducing some and increasing others.

It is perhaps appropriate to mention in this case that when assessing penalties we consider that it is correct that the entire conduct and behaviour of the Taxpayer should be taken into account and the facts looked at as a whole, rather than trying to analyse in detail and in abstract what the Taxpayer has done or failed to do. The simple facts of cases such as the one now before us are that the Taxpayer failed to keep proper accounts, failed to file tax returns and, when tax returns were filed, the same were incorrect. The amount of the penalties in monetary terms vary according to the undeclared profit which may have been made in any particular year. That is in accordance with the provisions of the Inland Revenue Ordinance. However, so far as the percentage of the maximum penalty which should be imposed is concerned, it would appear that the Taxpayer is no more blameworthy in one year than in another. The simple fact is that, throughout the period under review, the Taxpayer totally failed in his obligations under the Inland Revenue Ordinance.

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For the reasons given, we consider that the penalties imposed are not excessive in all of the circumstances and we dismiss this appeal and confirm all of the penalty tax assessments against which the Taxpayer has appealed.