

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D43/89

Penalty tax assessments – assets betterment statement – six years understatement of profits – quantum of penalty assessments – section 82A of the Inland Revenue Ordinance.

Panel: T J Gregory (chairman), Gordon M Macwhinnie and Lincoln Yung Chu Kuen.

Date of hearing: 27 January 1989.

Date of decision: 30 August 1989.

The taxpayer had carried on business in Hong Kong for many years. In 1986 the Inland Revenue Department conducted an investigation into the tax affairs of the taxpayer. An assets betterment statement was prepared and the taxpayer was assessed to additional tax. The profits of the taxpayer for the years of assessment from 1980/81 to 1985/86 inclusive were \$2,592,301 before the investigation and \$7,861,059 after the investigation with understated profits of \$5,258,161 and tax understated of \$883,020. The Commissioner then exercised his powers under section 82A of the Inland Revenue Ordinance and imposed additional penalty tax upon the taxpayer of \$808,400 in respect of the six years in question. The taxpayer appealed to the Board of Review and argued that the penalty tax assessments were excessive because the taxpayer had not tried to evade tax and had not been able to keep proper books of account. As a result he had not been able to challenge the accuracy of the assets betterment statement.

Held:

The appeal was dismissed. Ignorance of the law is no excuse to file honest and correct tax returns. Pressure of business is not an excuse. Most businessmen in Hong Kong are diligent in discharging their responsibilities under the Inland Revenue Ordinance and those who concealed their true tax liability were benefiting from those who were honest and made proper tax returns.

Appeal dismissed.

Case referred to:

BR 4/72, IRBRD, vol 1, 77

Tung Kar Che for the Commissioner of Inland Revenue.
Thomson Lai of Y W Lai & Co for the taxpayer.

INLAND REVENUE BOARD OF REVIEW DECISIONS

Decision:

1. THE NATURE OF THE APPEAL

The Taxpayer appealed against the quantum of additional tax assessed upon him for the years of assessment 1980/81 to 1985/86, inclusive.

2. THE FACTS

2.1 The Taxpayer carried on a business from June 1978 as a sub-contractor manufacturing plastic products under the business name 'A company' (the 'company'). The company ceased in December 1985 when its business was acquired by a corporation 'B Limited', the issued share capital of which was held in the name of the Taxpayer's children.

2.2 Profits tax returns for the company for the years of assessment 1980/81 to 1985/86, both inclusive, signed by the Taxpayer were submitted showing the following profits.

<u>Year of Assessment</u>	<u>Basis Period</u> (year ended)	<u>Date of Filing Return</u>	<u>Profits/ (loss) per Return</u> \$	<u>Assessed Profit/(Loss) after Computational Adjustments</u> \$
1980/81	31-3-81	8-6-81	(4,015)	(4,015)
1981/82	31-3-82	8-6-82	(10,587)	(10,597)
1982/83	31-3-83	9-6-83	35,802	35,802
1983/84	31-3-84	30-11-84	70,802	87,644
1984/85	31-3-85	16-9-85	134,968	135,012
1985/86	1-4-85 to 31-12-85	25-6-87	2,327,959	2,327,959

2.3 In early 1986 the Inland Revenue Department ('the Revenue') started to review the tax affairs of the Taxpayer.

2.4 By letter dated 15 April 1986, the Taxpayer appointed a firm of certified public accountants ('the tax representative') to represent him. On 2 June 1986 the tax representative confirmed to the assessor that the Taxpayer was willing to make a voluntary disclosure with respect to his income for the period from 1 April 1980 to 31 March 1985 and that efforts would be made towards the compilation of an assets betterment statement ('ABS'). Between 12 September 1986 and 30

INLAND REVENUE BOARD OF REVIEW DECISIONS

November 1987 there was correspondence and meetings with respect to an ABS and, eventually, an ABS dated 30 November 1987 was accepted and signed by the Taxpayer in the presence of his tax representative.

- 2.5 Whilst the investigation was in progress the following estimated assessments were issued to the Taxpayer:

<u>Year of Assessment</u>	<u>Date of Issue</u>	<u>Assessable Profits</u> \$
1980/81	9-3-87	300,000
1985/86	20-5-87	3,000,000

- 2.6 The Taxpayer through the tax representative lodged an objection to these estimated assessments on the grounds that they were excessive and a profits tax return for the year of assessment 1985/86 was also submitted to validate the objection.

- 2.7 On 21 October 1987 estimated assessments for the years of assessment 1981/82 to 1984/85 were issued as follows:

<u>Year of Assessment</u>	<u>Assessable Profits/ Additional Assessable Profits</u> \$
1981/82	495,270
1982/83	225,045 (Additional)
1983/84	994,864 (Additional)
1984/85	2,597,743 (Additional)

- 2.8 The Taxpayer, through the tax representative, lodged an objection against the assessments for the years of assessment 1981/82 and 1982/83 but no objection was made in respect of the assessments for the years of assessment 1983/84 and 1984/85.

- 2.9 As a result of the acceptance and signing by the Taxpayer of the ABS, on 14 December 1987, with reliance being placed on the revised ABS, the assessments for the years of assessment 1980/81 to 1982/83 and 1985/86 were revised as follows:

<u>Year of Assessment</u>	<u>Revised Assessable Profits/ *Revised Additional Assessable Profits</u> \$
---------------------------	---

INLAND REVENUE BOARD OF REVIEW DECISIONS

1980/81	202,026
1981/82	485,270
1982/83	215,045
1985/86	3,107,653

2.10 A comparative table of the assessable profits before and after investigation and the amount of tax undercharged in consequence of the submitted incorrect profits tax returns of the company is as follows:

<u>Year of Assessment</u>	Profits (Loss) before <u>Investigation</u> \$	Profits after <u>Investigation</u> \$	Profits <u>Understated</u> \$	Tax <u>Understated</u> \$
1980/81	16,481	202,026	185,545	30,303
1981/82	(10,597)	485,270	485,270	72,790
1982/83	35,802	250,847	215,045	37,627
1983/84	87,644	1,082,508	994,864	161,362
1984/85	135,012	2,732,755	2,597,743	448,390
1985/86	<u>2,327,959</u>	<u>3,107,653</u>	<u>779,694</u>	<u>132,548</u>
	<u>2,592,301</u>	<u>7,861,059</u>	<u>5,258,161</u>	<u>883,020</u>

2.11 On 14 January 1988 the Commissioner issued a notice under section 82A (4) of the Inland Revenue Ordinance to the effect that he intended to assess additional tax under section 82A of the Ordinance. In response to this notice the Taxpayer submitted written representations through the tax representative. After taking into consideration these representations and the circumstances of the case on 24 February 1988 the Commissioner issued notices of assessment and demands for additional tax under section 82A for the years of assessment 1980/81 to 1985/86, inclusive, as follows:

<u>Year of Assessment</u>	Tax <u>Undercharged</u> \$	Section 82A <u>Additional Tax</u> \$
1980/81	30,303	30,300
1981/82	72,790	72,800
1982/83	37,627	37,600
1983/84	161,362	157,400
1984/85	448,390	400,500
1985/86	<u>132,548</u>	<u>109,800</u>
	<u>883,020</u>	<u>808,400</u>

INLAND REVENUE BOARD OF REVIEW DECISIONS

2.12 By notice dated 23 March 1988, the Taxpayer appealed to the Board against the assessments to additional tax.

3. DOCUMENTATION

The Board had before it copies of the following documents:

3.1 Appendix A: Letter 30 September 1981 from Inland Revenue Department to the Taxpayer together with profits tax computation;

3.2 Appendix B: Letter 2 July 1982 from Inland Revenue Department to the Taxpayer together with profits tax computation;

3.3 Appendix C: Notice of assessment for profits tax for the year of assessment 1982/83 together with profits tax computation;

3.4 Appendix D: Notice of assessment for profits tax for the year of assessment 1983/84 together with profits tax computation;

3.5 Appendix E: Notice of assessment for profits tax for the year of assessment 1984/85 together with profits tax computation;

3.6 Appendix F: Notice of assessment for profits tax for the year of assessment 1985/86 together with profits tax computation;

3.7 Appendix G: Letter 12 September 1986 from the tax representative to the Revenue;

3.8 Appendix H: Note of interview of the tax representative with the Revenue dated 11 March 1987;

3.9 Appendix I: Letter 9 June 1987 from the Revenue to the Taxpayer;

3.10 Appendix J: Letter 9 July 1987 from the tax representative to the Revenue;

3.11 Appendix K: Letter 19 October 1987 from the Revenue to the Taxpayer enclosing the ABS;

3.12 Appendix L: Letter 23 November 1987 from the tax representative to the Revenue;

3.13 Appendix M: Revised ABS;

3.14 Appendix N: Letter 14 January 1988 from the Revenue to the Taxpayer;

INLAND REVENUE BOARD OF REVIEW DECISIONS

- 3.15 Appendix O: Letter 30 January 1988 from the tax representative to the Revenue;
- 3.16 Letter 23 March 1988 from the tax representative to the Clerk to the Board of Review enclosing:
 - 3.16.1 Statement of the grounds of appeal from the assessments to additional taxes;
 - 3.16.2 Letter 24 February 1988 from the Revenue to the Taxpayer re: profits tax for the year of assessment 1980/81;
 - 3.16.3 Letter 24 February 1988 from the Revenue to the Taxpayer re: profits tax for the year of assessment 1981/82;
 - 3.16.4 Letter 24 February 1988 from the Revenue to the Taxpayer re: profits tax for the year of assessment 1982/83;
 - 3.16.5 Letter 24 February 1988 from the Revenue to the Taxpayer re: profits tax for the year of assessment 1983/84;
 - 3.16.6 Letter 24 February 1988 from the Revenue to the Taxpayer re: profits tax for the year of assessment 1984/85;
 - 3.16.7 Letter 24 February 1988 from the Revenue to the Taxpayer re: profits tax for the year of assessment 1985/86;
 - 3.16.8 Letter 30 January 1988 from the tax representative to the Revenue;
 - 3.16.9 Letter 14 January 1988 from the Revenue to the Taxpayer.

4. THE HEARING OF THE APPEAL

- 4.1 At the appeal the Taxpayer was represented by the tax representative who handed in a written submission.
- 4.2 The tax representative proceeded to comment to the Board on the grounds of appeal and pointed out that the grounds of appeal clearly set out the following main points:
 - 4.2.1 That the additional taxes are excessive in considering his client's background and circumstances on those years of assessment concerned.
 - 4.2.1.1 The Taxpayer never had any intention to understate his income. He did not make any arrangements to lower his tax liabilities. In fact, his wife and

INLAND REVENUE BOARD OF REVIEW DECISIONS

children only drew nominal salaries from the company so that the company could survive. As mentioned in the representation to the Commissioner, the Taxpayer had been working hard in securing business in earlier years and the sudden increase in the volume of business left him totally disorganized in managing the accounting functions. This is evidenced in the amount of discrepancies computed in the ABS which were very low in the years of assessment 1980/81 to 1982/83. The discrepancies in these years were, in the tax representative's opinion, mainly due to accounting cut-off adjustments.

- 4.2.1.2 With no proper records to substantiate his previous tax returns, the Taxpayer voluntarily disclosed his assets and liabilities when the tax representative advised him to do so in early 1986. The ABS thus prepared might be distorted by the unaudited opening and closing figures. The Taxpayer considered that he was taxed more than the actual income. With no records and evidence to object the statement, the Taxpayer reluctantly accepted the discrepancies.
- 4.2.1.3 It is the tax representative's opinion that the penalty taxes levied on the betterment profits were heavier than the situation warranted. The Taxpayer had already been penalized by paying more taxes than his actual income merited because he could not keep proper books and records.
- 4.2.2 Unidentified withdrawal from bank amounting to \$1,290,958 in the year of assessment 1985/86 should not be considered as understatement of the profits.
- 4.2.2.1 The accounts for the year ended 31 December 1985 were prepared by the tax representative in utmost good faith from books and records of the company. They had reconciled the sale and purchase figures to the debtors and creditors accounts. All the unidentified withdrawals, which might represent genuine business expenses, were excluded in arriving at the profits figures.
- 4.2.2.2 There was clearly no understatement of the profits by these unidentified withdrawals. It is well accepted that no one could recall a few cash withdrawals and payments made a few years ago. By adding back these withdrawals to the ABS, the Taxpayer had already accepted and paid tax on these amounts. The discrepancy for the year of assessment 1985/86 was solely attributable to this asset betterment adjustment and was not due to any understatement of any income.
- 4.2.3 Throughout the tax investigation the Taxpayer had been very co-operative and was willing to supply the information the Revenue required. His sincere assistance enhanced the smooth processing of the whole exercise which inevitably reduced the time involved by the Inland Revenue Department and shortened the duration of the investigation. So far as the tax representative understood from the Revenue, the Revenue was quite satisfied with the

INLAND REVENUE BOARD OF REVIEW DECISIONS

expeditious processing of the case and, hence, the Taxpayer cannot agree to the heavy additional penalties that the Commissioner ordered upon him.

- 4.2.4 The submission concluded with the statement that the Taxpayer had had to work hard to enable his business to survive. His lack of income precluded him sending his children to receive a better education and the family, that is the Taxpayer, his wife and children, had to work night and day to make a minimum living. A daughter had lost two fingers when working some of the machinery. In spite of all these difficulties the family as a unit had built a prosperous business. The tax representative questioned whether the Government, as a matter of policy, should penalize such hardworking people because they were insufficiently educated to file accurate tax returns.

5. THE REVENUE'S SUBMISSION

The Revenue's submission was also in writing and may be briefly summarised as follows:

- 5.1 The onus in an appeal was on the Taxpayer.
- 5.2 The assessments were not excessive and the grounds of appeal required the following comments:
- 5.2.1 That the Taxpayer had only been penalized because he did not keep proper books and records.

Section 51C(l) of the Ordinance requires any person carrying on a business to keep sufficient books and records of his business for a period of not less than seven years; the Taxpayer failed to comply with this requirement and sought to excuse himself on the basis that the sudden increase in the volume of the business left him totally disorganized in managing the accounting functions. This was not a valid excuse. Further, criticism of the ABS could not be admitted as it had been accepted by the Taxpayer with benefit of professional advice.

- 5.2.2 Unidentified withdrawals:
- 5.2.2.1 In compiling an ABS adjustments have to be made to funds withdrawn from banks for identified purposes. Adjustments are made on the assumption that such withdrawals are not an allowable expenditure connected with a taxpayer's business and it is the responsibility of the taxpayer to satisfy the Revenue that the funds withdrawn were for payment of deductible expenses, refer BR 4/72, IRBRD, vol 1, 77.

INLAND REVENUE BOARD OF REVIEW DECISIONS

5.2.2.2 On a factual basis the total amount of identified bank withdrawals was \$2,250,958 of which, after explanations were provided by the Taxpayer, a total of \$960,000 had been deducted. It was only those cash withdrawals which were not supported by further details or documentary evidence that the Revenue had disallowed.

5.2.3 The Taxpayer's allegation that no person could be expected to recall a few cash withdrawals with respect to transactions entered into several years previously.

An examination of the schedules annexed to appendices I and J to the agreed statement of facts disclosed cash withdrawals in the region of \$50,000 to \$500,000 between September 1985 and February 1986, namely no earlier than eight and no more recently than two months before the Taxpayer appointed the tax representative to deal with the investigation. The excuse of lapse of time was not available and the Board should not take cognizance of the Taxpayer's suggestion in this respect.

5.2.4 Ground three: The Taxpayer had been very co-operative and was willing to supply information that shortened the duration of the investigation.

5.2.4.1 The degree of co-operation of the Taxpayer had been duly noted and taken into account by the Commissioner in making the additional tax assessments. Factually, the investigation was stated by the Inland Revenue Department in early 1986 and the Taxpayer was interviewed on 11 March 1987 when he was duly advised of the penalty provisions. Notwithstanding that, the Taxpayer filed an incorrect return for the year of assessment 1985/86 on 25 June 1987, just over three months after the interview, which understated profits by \$779,694 for that year.

5.2.5 The Revenue's representative drew to the Board's attention:

5.2.5.1 the fact that this was a serious case of tax evasion. The Taxpayer had been in business since 1978 and yet in his tax returns for the years 1980/81 to 1984/85 he declared annual profits in amount ranging from \$0 to \$135,000 when his true profits were between some \$200,000 and \$2,700,000. For the year of assessment 1985/86 he only returned 75% of his true profits. The total profits understated were \$5,200,000 – a substantial omission.

5.2.5.2 Under section 82A the maximum amount of additional tax to which the Taxpayer was liable is three times the tax undercharged, that is three times \$883,020 or \$2,649,060. The amount of additional tax assessed by the Commissioner, after taking into account the whole circumstances of the case, was \$808,400 which was only 91.5% of the tax undercharged or 30.5% of the maximum penalty.

INLAND REVENUE BOARD OF REVIEW DECISIONS

6. REASONS FOR THE DECISION

- 6.1 As the Board had stated on frequent occasions, alleged ignorance of the law is no excuse for failing to file honest and correct tax returns. Additionally, pressure of business is not an excuse for failure to discharge the obligations imposed by the Ordinance.
- 6.2 The tax representative reminded the Board that Hong Kong's success and prosperity was founded on entrepreneurs who started a small business and by dedicated effort built up their respective businesses until they became material contributors to Hong Kong's prosperity. The Board accepts this statement as a statement of fact. However, it does overlook the obvious: the vast majority of these businessmen have been diligent in the discharge of their responsibilities under Hong Kong's legislation, particularly the Ordinance and that, factually, those who concealed their true liability to profits tax were benefitting from those who were honest and made their proper contributions to Government revenue for the overall benefit of Hong Kong.
- 6.3 Nothing was drawn to the Board's attention to mitigate the gravity of this tax evasion and the Board considers that the Commissioner in assessing an amount of additional tax at less than the tax sought to be avoided has already taken into account all mitigating factors which had been drawn to his attention.
- 6.4 In all the circumstances the Board cannot accept that the additional tax imposed is in anyway excessive.

7. DECISION

For the reasons given this appeal is dismissed.