

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D45/90

Penalty tax – whether penalties excessive – section 82A of the Inland Revenue Ordinance.

Panel: William Turnbull (chairman), Karl Kwok Chi Leung and Alexander Woo Chung Ho.

Date of hearing: 22 August 1990.

Date of decision: 26 November 1990.

The taxpayer was the sole proprietor of a travel agency business which was subsequently incorporated. The taxpayer filed tax returns in respect of his business and was duly tax thereon. Following an investigation by the Inland Revenue Department it was found that the taxpayer had been undercharged to tax. The Commissioner then assessed the taxpayer to penalty tax pursuant to section 82A of the Inland Revenue Ordinance. When the taxpayer was being investigated, he disputed the profits which the assessor alleged he had made and appealed to the Board of Review against the assessments to tax, which had been assessed on the profits which it was alleged he had made and had under-declared. At the previous hearing before the Board of Review, the Board found in favour of the Commissioner on the ground that the taxpayer had not been able to discharge the onus of proof. At the hearing before the present Board of Review the taxpayer argued that the quantum of the penalty tax assessments was excessive.

Held:

The assessments were excessive and should be reduced. The case involved a new point of principle. Though the original assessments to tax on the profits undercharged were final and conclusive, they had been upheld by a previous Board of Review on the ground that the taxpayer had not been able to discharge the onus of proof imposed upon him. A distinction should be drawn between a case where a taxpayer is proved to be wrong and a case where a taxpayer is unable to discharge the onus of proof. In the circumstances the Board ordered the penalties to be reduced to 80% of the amount of the tax undercharged.

Appeal allowed in part.

Tse Woo Ping for the Commissioner of Inland Revenue.

Taxpayer in person.

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Decision:

This is an appeal by a taxpayer against additional tax assessments levied upon him under section 82A of the Inland Revenue Ordinance. The facts are as follows:

1. The Taxpayer was the sole proprietor of a travel agency business which commenced in 1965. In March 1983, the Taxpayer ceased his business when he caused it to be incorporated into a private limited company.
2. The Taxpayer submitted various profits tax returns for the years of assessment 1972/73 to 1982/83 inclusive declaring the following profit or loss in respect of his sole proprietorship business as follows:

<u>Year of Assessment</u>	<u>Period (Year Ended)</u>	<u>Returned Profits (Loss)</u> \$
1972/73	31-3-1973	15,383
1973/74	31-3-1974	11,950
1974/75	31-3-1975	(8,308)
1975/76	31-3-1976	37,921
1976/77	31-3-1977	70,958
1977/78	31-3-1978	107,152
1978/79	31-3-1979	129,305
1979/80	31-3-1980	203,225
1980/81	31-3-1981	147,520
1981/82	31-3-1982	233,940
1982/83	31-3-1983	(181,471)

3. The assessor raised the following profits tax assessments on the Taxpayer after making certain computational adjustments to the profits returned by the Taxpayer:

<u>Year of Assessment</u>	<u>Assessable Profits</u> \$	<u>Tax Payable thereon</u> \$
1975/76	50,150	7,522
1976/77	72,223	10,833
1977/78	106,850	16,027
1978/79	130,005	19,500
1979/80	203,225	30,483
1980/81	147,520	22,128
1981/82	233,940	35,091

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The Taxpayer did not file objection against any of these assessments.

4. The assessor carried out an investigation into the tax affairs of the Taxpayer covering the period from 1 April 1971 to 31 March 1983. In the course of the enquiries, the assessor raised a number of profits tax assessments and additional profits tax assessments on the Taxpayer against which the Taxpayer lodged objection on the ground that he had not made the profits as assessed.
5. The assessor proceeded to prepare an assets betterment statement for the period from 1 April 1971 to 31 March 1983. The Taxpayer took objection to the assets betterment statement and after lengthy negotiations and following a number of revisions to the original assets betterment statement, the assessor and the Taxpayer were unable to agree with the content of the assets betterment statement. In the absence of agreement, the objections then outstanding from the Taxpayer were put up for determination by the Commissioner of Inland Revenue.
6. By his determination dated 17 August 1987, the Commissioner determined the assessable profits of the travel agency business carried on by the Taxpayer. The Taxpayer lodged an appeal under section 66 of the Inland Revenue Ordinance against the Commissioner's written determination. The appeal was heard by the Board of Review on 12 July 1989. The appeal was adjourned to enable the Taxpayer to produce further evidence in support of his appeal. When the appeal had been heard in full by the Board of Review, the Board of Review by its decision issued on 24 November 1989 held that the Taxpayer had not been able to produce evidence to discharge the onus of proof placed upon a taxpayer under the Inland Revenue Ordinance. Accordingly they accepted the final revised assets betterment statement as being correct and directed that the tax assessments against which the Taxpayer had appealed should be confirmed save and except for the years of assessment 1975/76 to 1977/78 which would be revised in accordance with the accepted assets betterment statement in its then final form.
7. The following is a comparative table of the Taxpayer's assessable profits/(loss) before and after the investigation and the amount of tax undercharged according to the decision of the Board of Review:

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<u>Year of Assessment</u>	<u>Profits/(Loss) before Investigation</u> \$	<u>Profits after Investigation</u> \$	<u>Profits Under- charged</u> \$	<u>Loss Over- claim</u> \$	<u>Tax Under- Charged</u> \$
1972/73	15,383	73,619	58,236	-	8,735
1973/74	11,950	23,600	11,650	-	1,747
1974/75	(8,308)	164,698	164,698	8,308	24,704
1975/76	50,150	23,041	-	-	-
1976/77	72,223	1,037,315	965,092	-	144,763
1977/78	106,850	303,570	196,720	-	29,508
1978/79	130,005	691,643	561,638	-	84,245
1979/80	203,225	1,326,336	1,123,111	-	168,466
1980/81	147,520	1,584,977	1,437,457	-	215,618
1981/82	<u>233,940</u>	<u>883,321</u>	<u>649,381</u>	<u>-</u>	<u>97,407</u>
Total	962,938 =====	6,112,120 =====	5,167,983 =====	8,308 =====	775,193 =====

8. On 9 February 1990, the Commissioner issued a notice under section 82A(4) of the Inland Revenue Ordinance to the Taxpayer informing him that he proposed to impose additional tax upon the Taxpayer for submitting incorrect profits tax returns for the years of assessment 1972/73 to 1974/75 and 1976/77 to 1981/82.
9. The Taxpayer submitted written representations and after considering the representations, the Commissioner on 29 March 1990 issued the following notices of assessment and demands for additional tax under section 82A of the Inland Revenue Ordinance:

<u>Year of Assessment</u>	<u>Tax Undercharged</u> \$	<u>Section 82A Additional Tax</u> \$	<u>Percentage of Penalty Tax</u> %
1972/73	8,735	9,000	103
1973/74	1,747	2,000	114
1974/75	24,704	24,000	97
1976/77	144,763	144,000	99
1977/78	29,508	29,000	98
1978/79	84,245	84,000	100
1979/80	168,466	168,000	100
1980/81	215,618	215,000	100
1981/82	<u>97,407</u>	<u>97,000</u>	<u>100</u>
Total	775,193 =====	772,000 =====	100

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10. By letter dated 26 March 1990, the Taxpayer appealed to the Board of Review against the additional assessments levied under section 82A of the Inland Revenue Ordinance.

At the hearing of the appeal, the Taxpayer appeared in person. The main thrust of his submission was that he did not admit and agree that the tax returns previously submitted by him were incorrect. He points out that he had employed a professional firm of accountants to keep the accounts for his business and that he considered the accounts to be correct. He said that he had operated a number of other businesses in the names of limited companies and it was apparent from what he said that he had had during the period in question a complex business set up.

The Taxpayer pointed out that he had subsequently sold his shares in the limited company which had taken over his previous sole proprietorship. His reasons for selling his shares had been to pay off losses which he had incurred. The Taxpayer produces audited accounts of his limited company to support his statement that his travel agency business had been losing money but in answer to questions from the Board indicated that when he had sold his shares in the limited company, he had received a substantial price for them from a third party.

It was apparent from what the Taxpayer said that the turnover of his travel agency business had been substantial.

The representative for the Commissioner submitted that the penalties imposed upon the Taxpayer under section 82A of the Inland Revenue Ordinance were reasonable and not excessive in all of the circumstances. She submitted that recent Board of Review decisions had indicated that the starting point for additional tax was 100% of the tax undercharged where a person had failed in his obligations under the Inland Revenue Ordinance. She said that the Taxpayer was a sophisticated person who had been in business for a long period of time. She pointed out that much time had been spent by the staff of the Inland Revenue Department in investigating the case. The incorrect returns had lasted over many years and accordingly she considered that appropriate penalties would be in excess of the amount of tax undercharged. However, the Commissioner had chosen to impose penalties of only approximately 100% of the tax undercharged.

This is an interesting case because it is different in a material manner to other cases which have come before the Board in the past. It is common for taxpayers to submit that penalties are excessive because they consider the assets betterment statement to be incorrect. It is always necessary for this Board in such cases to point out to the taxpayer that once assessments have become final, they are final and conclusive for all purposes of the Ordinance including section 82A penalties. Accordingly it is not open to taxpayers to argue at the hearing of a section 82A appeal that the assessments are incorrect because they were based on an incorrect assets betterment statement. In the present case, the Taxpayer appealed against the original assessments which were made pursuant to the assets

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betterment statement in its final revised form. We have had the benefit of being able to read the Board of Review decision following the Taxpayer's appeal. From that decision it is clear that the Board of Review found against the Taxpayer not necessarily because what he was saying was incorrect but because he was unable to substantiate to their satisfaction what he alleged and the onus of proof was placed upon the Taxpayer.

This Board is bound by section 70 of the Inland Revenue Ordinance which provided that an assessment determined on appeal shall be final and conclusive for all purposes of the Inland Revenue Ordinance as regards the amount of such assessable income or profits. This Board is also bound by section 68(4) of the Inland Revenue Ordinance which states that the onus of proving that the assessment appealed against is excessive or incorrect shall be on the taxpayer. The question which we must decide is whether a penalty of approximately an amount equal to the tax undercharged is excessive in all of the circumstances. We have had the opportunity of hearing the taxpayer and listening to his submissions. Whilst we consider that the Taxpayer did understate his profits in the tax returns which he filed and whilst we consider that there is no excuse to say that he relied upon professional auditors, we feel some sympathy for the Taxpayer. Clearly he was the author of his own misfortunes because he was unable to maintain clear and accurate accounts for the many businesses and companies which he maintained inside and outside of Hong Kong. Had he kept detailed accounts and had he had a better knowledge of accounting matters, it may be that he would have had a more successful outcome to his first appeal before the Board of Review. We are conscious that in the decision of the first Board of Review reference is repeatedly made to the fact that the taxpayer was unable to substantiate what he claimed. That Board of Review repeatedly stated that he had failed to produce acceptable evidence rather than finding as a fact that his claim was wrong.

In all of the circumstances we consider that the penalties imposed in this case are excessive bearing in mind the unusual facts. We consider that penalties of approximately 80% of the amount of tax undercharged would have been appropriate and accordingly we order that the penalties appealed against should be reduced as follows:

<u>Year of Assessment</u>	<u>Tax Under-charged</u> \$	<u>S82A Tax Assessed by Commissioner</u> \$	<u>Percentage of Penalty Tax by Commissioner</u> %	<u>S82A Tax Reduced by the Board</u> \$	<u>Percentage of Penalty Tax by the Board</u> %
1972/73	8,735	9,000	103	7,000	80
1973/74	1,747	2,000	114	1,000	57
1974/75	24,704	24,000	97	20,000	81
1976/77	144,763	144,000	99	116,000	80
1977/78	29,508	29,000	98	24,000	81
1978/79	84,245	84,000	100	67,000	80
1979/80	168,466	168,000	100	135,000	80
1980/81	215,618	215,000	100	172,000	80

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1981/82	<u>97,407</u>	<u>97,000</u>	<u>100</u>	<u>78,000</u>	<u>80</u>
Total	775,193 =====	772,000 =====	100	620,000 =====	80