

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D4/89

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

Panel: William Turnbull (chairman), Gordon M Macwhinnie and Lincoln Yung Chu Kuen.

Date of hearing: 27 January 1989.

Date of decision: 11 April 1989.

The taxpayer carried on business as a fish seller. Over the course of seven years, she filed profits tax returns which understated her taxable profits by an average of 52%. Following enquiries by the IRD, revised assessments were issued which reflected her true liability to pay profits tax.

The Commissioner assessed penalties equal to an average of 50% of the maxima permitted. The taxpayer appealed.

Held:

The penalties were excessive and would be reduced to 33.33% of the maxima permitted.

- (a) Where a taxpayer has failed to keep proper accounts and file correct returns, as a general rule the penalty should be equal to the amount of tax undercharged.
- (b) It is no excuse for a taxpayer to plead that he or she does not understand tax laws, is illiterate or has employed a professional tax representative after discovering that he or she is in default.

Appeal allowed in part.

Raymond Ng for the Commissioner of Inland Revenue.

Taxpayer in person.

Decision:

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This is an appeal by the Taxpayer against the quantum of certain additional assessments imposed upon her by the Deputy Commissioner by way of penalty under section 82A of the Ordinance.

The facts are as follows:

1. The Taxpayer was carrying on business as a fish wholesaler and retailer commencing in 1974. The Taxpayer carried on her business from a boat which was berthed at the water front near the Tsuen Wan Ferry Pier, and in November 1981 she was forced by the authorities to move her boat to Castle Peak Bay.
2. The Taxpayer obtained a mobile hawker's licence in 1975 and she subsequently applied for a business registration certificate. This was rejected because she did not have a permanent address.
3. The Taxpayer kept a cash book in which she recorded the sales purchases and expenses of her business, but she did not keep any vouchers to substantiate any of her sales and purchases.
4. The Taxpayer filed tax returns as follows:

<u>Year of Assessment</u>	<u>Date of Filing</u>	<u>Period of Account</u> year ended	<u>Profits Returned</u> \$
1975/76	23-3-81	31-12-75	37,009
1976/77	23-3-81	31-12-76	34,149
1977/78	23-3-81	31-12-77	39,014
1978/79	23-3-81	31-12-78	40,461
1979/80	23-3-81	31-12-79	46,548
1980/81	24-10-81	31-12-80	61,834
1981/82	19-3-84	31-12-81	87,250

5. In July 1981, the assessor made enquiries into the tax affairs of the Taxpayer and issued a number of estimated assessments. The Taxpayer employed a tax representative who lodged objection to the estimated assessments. On 13 May 1986, the Taxpayer agreed to accept tax assessments on a total assessable profit of \$720,000 for the years of assessment 1975/76 to 1981/82 as follows:

<u>Year of Assessment</u>	<u>Agreed Assessable Profits</u> \$
1975/76	80,000
1976/77	80,000

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1977/78	100,000
1978/79	100,000
1979/80	120,000
1980/81	120,000
1981/82	<u>120,000</u>
	<u>\$720,000</u>

On 9 June 1986, revised profits tax assessments were issued for the years 1976/77 to 1979/80 and profits tax assessments were issued for the years 1980/81 and 1981/82 based on the agreed amounts.

6. The following table shows the relevant figures of profits and tax before and after the investigation by the assessor:

<u>Year of Assessment</u>	<u>Profits before investigation</u>	<u>Profits after investigation</u>	<u>Profit Under-stated</u> (C) = (B) – (A)	<u>Tax before investigation</u>	<u>Tax after investigation</u>	<u>Tax Under-charged</u> (F) = (E) – (D)
	(A)	(B)	(B) – (A)	(D)	(E)	(E) – (D)
	\$	\$	\$	\$	\$	\$
1975/76	37,009	80,000	42,991	650	8,850	8,200
1976/77	34,149	80,000	45,851	176	8,400	8,224
1977/78	39,014	100,000	60,986	884	15,617	14,733
1978/79	40,461	100,000	59,539	100	11,250	11,150
1979/80	46,548	120,000	73,452	77	13,750	13,673
1980/81	61,834	120,000	58,166	Nil	8,500	8,500
1981/82	<u>87,250</u>	<u>120,000</u>	<u>32,750</u>	<u>362</u>	<u>5,000</u>	<u>4,638</u>
	<u>\$346,265</u>	<u>\$720,000</u>	<u>\$373,735</u>	<u>\$2,249</u>	<u>\$71,367</u>	<u>\$69,118</u>

7. The Deputy Commissioner of Inland Revenue gave notice to the Taxpayer that he intended to assess additional tax by way of penalty under section 82A of the Inland Revenue Ordinance because the Taxpayer had without reasonable excuse made incorrect profits tax returns for the years of assessment 1975/76 to 1981/82.
8. After taking into account representations made by the tax representative of the Taxpayer, the assessor imposed the following penalty tax assessments upon the Taxpayer.

<u>Year of Assessment</u>	<u>Section 82A Penalty Tax</u>	<u>Penalty as Percentage of Tax Undercharged</u>
	\$	

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1975/76	12,300	150%
1976/77	12,300	150%
1977/78	22,100	150%
1978/79	16,700	150%
1979/80	20,500	150%
1980/81	12,400	146%
1981/82	<u>6,400</u>	<u>138%</u>
	<u>\$102,700</u>	<u>149%</u>

At the hearing, the Taxpayer appeared herself and was represented by her son. She explained that she could no longer afford to pay for the services of a professional tax representative. She and her son said that she was not a tax expert or accountant and had incurred heavy expenses in this case in employing the services of a professional tax representative. They said that the Taxpayer was illiterate and that the Taxpayer had returned in her tax returns profits of approximately \$50,000 on average and that the Inland Revenue Department had assessed tax on profits of above \$100,000 on average. She claimed that she had employed her three sons in the business and that she should have been allowed wages to be offset against the profits of her business. She explained that she had not paid her sons any wages because she wished to save the money until they were married when she would give it to them.

In answer to questions from members of the Board, it was apparent that there was considerable confusion with regard to the requirement of the Taxpayer to register under the Business Registration Ordinance. This confusion appeared to lie both with the Taxpayer and with the relevant authorities. She explained to the Board that, when she had obtained her hawker's licence, she had endeavoured to register her business under the Business Registration Ordinance. This had been rejected because she had no permanent address. In reality, it would appear that she was not required to register under the Business Registration Ordinance because she was a licenced hawker. However, when the Inland Revenue Department made enquiries into her business in 1980/81, she was informed that she should have a business registration certificate. It would appear that, following the instructions of the Inland Revenue Department staff who were enquiring into her case, she was able to register her business whether it was legally necessary or not. As the question of whether or not a business registration certificate was required by the Taxpayer is not for decision by this Board, we do no more than record the relevant facts.

The representative for the Commissioner pointed out that the Taxpayer was required to obtain a marine hawker's licence under the Marine Hawkers Ordinance and that the Business Registration Ordinance exempts such persons from registering their businesses. However, he pointed out that the Business Registration Ordinance is separate from the Inland Revenue Ordinance and it does not exempt people from filing true and correct tax returns and duly paying tax. He pointed out that it is no excuse if a person is

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illiterate or employs the services of a professional tax representative to file tax return. The duty is imposed upon the Taxpayer by the law.

With regard to the question of payment of salary to members of the Taxpayer's family, the Commissioner's representative pointed out that the Taxpayer had claimed salary due to one of her sons only and this had been allowed by the assessor. The Taxpayer had not claimed that she paid any salaries to any other members of her family and had not included any such sums in the accounts which she herself had prepared. Accordingly, it was not appropriate that any further deductions should be made from her profits to provide for notional salaries which had not been paid.

Having heard the parties and having carefully considered the facts and the submissions before us, we are of the opinion that the penalties imposed by the Deputy Commissioner in this case are excessive. As a general rule, the penalty to be imposed where a Taxpayer has failed in his or her obligations under the Inland Revenue Ordinance to keep proper accounts and file true and correct tax returns is an amount equal to the amount of tax which has been undercharged. In this case, the amount of tax undercharged was \$69,118 and we consider that such an amount is the appropriate penalty in this case.

We have some sympathy for the Taxpayer because she attempted to register her business under the Business Registration Ordinance. She employed the services of a professional tax representative when she found out that she had failed in her obligations under the Inland Revenue Ordinance though, as she had kept no adequate records of her business, it would be difficult to prepare and file accurate tax returns. Furthermore, it would appear that, if she had had more knowledge of taxation matters, she could perhaps have managed her business in a way to reduce her liability to tax. However, it is not for us to speculate on whether or not she could have reduced her tax liability if she had employed and remunerated members of her family. The fact is that she did not do so and accordingly we are not able to take into account hypothetical circumstances.

Whilst we have some sympathy for the Taxpayer, it is clear that proprietors of small businesses are just as liable to pay tax as anyone else in Hong Kong and it is no excuse to say that one does not understand tax laws, is illiterate, or has employed a professional tax representative. The Inland Revenue Ordinance makes provision for heavy penalties to be imposed on those who fail in their obligations.

In all of the circumstances, we consider that the penalties imposed by the Deputy Commissioner are excessive but do not consider that it is appropriate to reduce them below the norm of the amount of tax undercharged which is common in cases of this type. Accordingly, we order that the penalty tax assessments be reduced as follows:

<u>Year of Assessment</u>	<u>Section 82A Penalty Tax by Deputy Commissioner</u>	<u>Amount of Section 82A Penalty Tax as reduced by Board of Review</u>
	\$	\$

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	<u>\$102,700</u>	<u>\$69,118</u>