

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D4/90

Penalty tax – investigation by Inland Revenue Department – assets betterment statement final and conclusive – penalties of 44% of the maximum not excessive – section 82A of the Inland Revenue Ordinance.

Panel: Henry Litton QC (chairman), Sydney Leong Siu Wing and Tse Tak Yin.

Date of hearing: 23 February 1990.

Date of decision: 17 April 1990.

The taxpayer filed various profits tax returns which substantially under-declared the taxable profits of the taxpayer. An investigation was made into the tax affairs of the taxpayer and following an assets betterment procedure the taxpayer was assessed to tax on sums which were very substantially in excess of the amounts as originally stated by the taxpayer in the tax returns which had been filed. Penalties were imposed by the Commissioner which totalled approximately 134% of the tax undercharged. The taxpayer appealed to the Board of Review and submitted that the quantum was excessive.

Held:

The quantum was not excessive. The taxpayer had been professionally represented for some period of time. Poverty is not a ground for reducing the penalties but only for consideration in relation to when the penalties should be paid.

Appeal dismissed.

[Editor's note: The taxpayer has filed an appeal against this decision.]

Tse Hon Kin for the Commissioner of Inland Revenue.

Taxpayer represented by its tax representative.

Decision:

Introduction

1. This is an appeal against an additional assessment made by the Commissioner under the provisions of section 82A of the Inland Revenue Ordinance.

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2. This matter has a long history. The years of assessment with which this appeal is concerned are the five years, 1978/79 to 1982/83. The description of the Taxpayer's business as stated in the profits tax returns was 'chartering, transportation, general labour and heavy lift contractor'. The business included the chartering of ferries and pleasure boats and, in the later periods, the construction and also the purchase and sale of boats. In 1980 the Taxpayer rented a piece of land from the Government for the purpose of constructing and operating a shipyard. Capital expenditure was incurred in the building and equipping of the shipyard. It is not clear from the evidence when the shipyard started operations. The profits as returned by the Taxpayer in accordance with the profits tax returns lodged by him were as follows:

<u>Year of Assessment</u>	<u>Profits per Return</u> \$
1978/79	46,492
1979/80	57,440
1980/81	69,772
1981/82	98,827
1982/83	71,680

Tax Investigation

3. In 1985, the assessor commenced an investigation into the Taxpayer's tax affairs. On 6 November 1985 the Taxpayer through his tax representative, a firm of certified public accountants, submitted revised profits tax computations and supporting schedules for the years of assessment 1979/80 to 1984/85 showing very considerable discrepancies in the assessable profits. The revised assessable profits as proposed by the tax representative were computed essentially on the basis that certain capital items previously claimed as expenditure in the profits tax returns should be added back to the computation. These revised profits tax computations were not accepted by the assessor.

4. On 9 June 1986 the Taxpayer through his tax representative submitted a proposed assets betterment statement for the period 31 March 1978 to 31 March 1984 showing even greater discrepancies between the betterment profits and the original returns.

5. The assessor was not prepared to accept the proposed assets betterment statement without further enquiry, but attempts to get information from the Taxpayer were without success. The Taxpayer either had no books of accounts and business records or, if he had, he was not prepared to produce them for inspection.

6. After laborious enquiries from banks and other third parties, the chief assessor made an assets betterment statement which he issued on 13 March 1988 for the period 1978/79 to 1982/83 showing the following discrepancies:

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<u>Year of Assessment</u>	<u>Betterment Profits</u> \$	<u>Profits Assessed</u> \$	<u>Discrepancies</u> \$
1978/79	143,846	46,492	97,354
1979/80	578,026	57,440	520,586
1980/81	1,468,103	69,772	1,398,331
1981/82	3,764,970	98,827	3,666,143
1982/83	<u>1,130,969</u>	<u>71,680</u>	<u>1,059,289</u>
	7,085,914 =====	344,211 =====	6,741,703 =====

7. On 29 April 1988 the tax representative on behalf of the Taxpayer, returned to the Inland Revenue Department the assets betterment statement signed by the Taxpayer with an amendment, the estimated living expenses being reduced from \$900,000 to \$700,000. The result of the assessments, as amended, was that the total discrepancies for the five years in question between the profits as originally returned and as finally assessed in accordance with the assets betterment statement was \$6,541,703. The amount of tax undercharged represented 98.3% of the total tax that would have been charged had there been no understatement of profits in the returns.

8. On 15 July 1988 the Commissioner gave notice to the Taxpayer under section 82A(4) that he proposed to assess the Taxpayer to additional tax on account of the incorrect profits tax returns submitted for the years of assessment 1978/79 to 1982/83.

9. On 11 August 1988 the Taxpayer through his tax representative made representations to the Commissioner. In essence, the explanation was that the understated profits amounting to \$6,541,703 were mainly due to:

- (a) Misconception between capital and revenue expenditure: the acquisition cost of 'fixed assets, mainly motor vehicles' amounting to about \$3,000,000 had been wrongly treated by the accounts clerk as revenue expenditure.
- (b) Poor knowledge of accounting; the consequence of this being that the internal records of the business were very poor.
- (c) Lack of time spent on internal office administration and records: this was due to rapid expansion of the business since 1980.

It was also stated on behalf of the Taxpayer that since the period in question the business had suffered very serious losses.

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10. In the result, the Commissioner exercised his powers under section 82A to impose additional tax representing 44% of the maximum penalty for which the Taxpayer was liable under law. The details of the section 82A assessments are as follows:

<u>Year of Assessment</u>	<u>Tax Undercharged</u> \$	<u>Maximum Additional Tax</u> \$	<u>Additional Tax Assessed</u> \$
1978/79	16,347	49,041	22,000
1979/80	82,109	246,327	209,000
1980/81	213,977	641,931	288,000
1981/82	554,946	1,664,838	749,000
1982/83	<u>147,425</u>	<u>442,275</u>	<u>194,000</u>
	1,014,804	3,044,412	1,462,000
	=====	=====	=====

The section 82A assessment comes to 134% of the tax undercharged, as computed on the basis of the estimated assessments arrived at by the assets betterment method.

The Appeal

11. Notice of appeal against the Commissioner's section 82A assessments was lodged on 16 September 1988. The grounds of appeal are identical to the representations made by the tax representative to the Commissioner dated 11 August 1988 (see paragraph 9 above).

12. On 24 November 1989 the Taxpayer was given notice by the Clerk to the Board of Review of the hearing of his appeal scheduled on 23 February 1990.

13. At the hearing two representatives appeared for the Taxpayer. First, a Miss X, who is a secretary employed by the Taxpayer appeared before us and sought an adjournment of the hearing on behalf of the Taxpayer. When asked the reasons why she sought the adjournment, she said that the matter would be dealt with by Mr Y. Mr Y then came forward as the Taxpayer's representative and applied for an adjournment, the principal reason being that 'additional information' had come into his hands 'in recent months' which threw light on the Taxpayer's assets and liabilities. We refused the application to adjourn as being totally without merit, having regard to the fact that Mr Y's firm had been representing the Taxpayer since the year 1985.

14. The hearing then proceeded. It was not easy to understand the point being put forward on behalf of the Taxpayer by his representative Mr Y. In essence, it was that the Taxpayer had liabilities far greater than those which went into the assets betterment

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computation. This point appeared to us irrelevant as the revised profits tax assessments had become final and conclusive for all purposes under the Inland Revenue Ordinance. The Taxpayer was bound by the provisions of section 82B to the grounds of appeal as set out in the statute.

15. As regards the question whether the imposition of additional tax under section 82A was excessive, having regard to all the circumstances of the case, very little was said by the Taxpayer or by his representative on his behalf beyond the fact that the Taxpayer had no knowledge or expertise in relation to bookkeeping, his primary concern being, he stated, in 'steering ships'. He also said that in the period 1984/88 his business suffered great loss; his funds were frozen and he was not in a position to pay heavy penalties.

Conclusion

16. This matter has dragged on for many years. Whilst we appreciate that the assets betterment method of assessment provides only a very rough guide to the true profits of a business, and errors in computation tend to favour the Inland Revenue Department rather than the taxpayer, nevertheless, the penalty imposed by the Commissioner amounting to 134% of the tax undercharged is not, in our view, excessive. We have regard to the fact that from an early stage the Taxpayer was professionally represented by a firm of certified public accountants, and it was the Taxpayer who, in the first place, put forward an assets betterment statement as the basis for reassessing his profits tax liability. Ultimately the Taxpayer signed the assets betterment statement prepared by the Inland Revenue Department with the revision for living expenses as referred to in paragraph 7 above. No points of substance have been put forward by the Taxpayer to suggest that the section 82A assessment was excessive. Poverty is a misfortune, and might well be a relevant factor to consider as regards the terms under which the Taxpayer might be required by the Commissioner to pay the additional tax. Poverty, however, is not on its own a relevant factor on an appeal under section 82B of the Inland Revenue Ordinance. This appeal is accordingly dismissed.