

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D49/91

Penalty tax – failure to return true profits – quantum of penalties – mitigating circumstances – section 82A of the Inland Revenue Ordinance.

Panel: William Turnbull (chairman), Walter Chan Kar Lok and John C Broadley.

Date of hearing: 29 May 1991.

Date of decision: 5 September 1991.

The taxpayer carried on business as a manufacturer and wholesaler in partnership with others. The partnership was dissolved and the taxpayer became the sole proprietor. The taxpayer filed various profits tax returns which after investigation were proved to be incorrect. Penalties were imposed under section 82A of the Inland Revenue Ordinance which averaged 123% of the tax undercharged. The taxpayer appealed to the Board of Review.

Held:

There were both aggravating and mitigating factors. The quantum of the understatement of profits was substantial and there was doubt as to whether the taxpayer had given his fullest co-operation. However, he had given co-operation. Mitigating factors were the low level of education of the taxpayer who was not a man of great sophistication and his business was not very sophisticated. His records had been destroyed by fire. In all of the circumstances, the norm of penalties equal to 100% of the tax undercharged was appropriate and the Board ordered the penalties to be reduced accordingly.

Appeal allowed in part.

Cases referred to:

D63/88, IRBRD, vol 4, 69

D69/89, IRBRD, vol 5, 67

D4/90, IRBRD, vol 5, 86

Lee Wai Kwok for the Commissioner of Inland Revenue.

Taxpayer in person.

Decision:

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

1. The Taxpayer was a partner in a business which commenced trading in 1980 as a manufacturer and wholesaler. There were six partners, two of whom were resident in Hong Kong and four of whom were resident overseas. The partnership was ultimately dissolved in 1982 leaving the Taxpayer as the sole proprietor.
2. The Taxpayer filed profits tax returns for the business for the years of assessment 1981/82 and 1982/83 as the precedent partner thereof and profits tax returns for the business for the years of assessment 1983/84 to 1986/87 inclusive as the sole proprietor. The tax returns filed by the Taxpayer were accepted by the assessor and assessments were made accordingly.
3. The tax affairs of the Taxpayer were reviewed by the Inland Revenue Department. On 29 March 1988, the assessor raised an additional assessment on the business for the year of assessment 1981/82 and the Taxpayer lodged an objection against this assessment.
4. On 16 January 1989, the Taxpayer attended an interview with two investigation officers of the Inland Revenue Department. He confirmed that the profits tax returns for the years of assessment 1981/82 to 1986/87 were correct.
5. By a letter dated 27 April 1989, the Taxpayer was asked to furnish further information which was submitted by the tax representative for the Taxpayer which was a firm of certified public accountants on 2 June 1989.
6. On various dates, the assessor raised estimated assessments on the business for the years of assessment 1982/83 and 1983/84 against which the Taxpayer lodged objection through his tax representative.
7. After extensive enquires and analysis of bank accounts an assets betterment statement for the period from 1 April 1981 to 31 March 1987 was issued on 17 July 1990 to the Taxpayer which showed discrepancies of \$2,704,654. The Taxpayer was invited to make representations with regard to the same.
8. In default of any representations from the Taxpayer, the assessor raised additional profits tax assessments based on the assets betterment statement on the business on 31 August 1990 for the years of assessment 1984/85 to 1986/87 inclusive.

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9. The Taxpayer attended an interview with the investigation officers on 25 September 1990 and lodged objection against the additional profits tax assessments which had been issued to him for the years of assessment 1984/85 to 1986/87 inclusive. The assets betterment statement was discussed and clarified at the same interview with the assessor. Certain deductions were agreed and the Taxpayer signified his acceptance of the revised discrepancies which then amounted to \$2,095,654. The Taxpayer also agreed as to how the discrepancies should be attributed. The revised assets betterment statement was signed by the Taxpayer. Before the Taxpayer agreed to the assets betterment statement, the penalty provisions of section 82A of the Inland Revenue Ordinance were explained to him.
10. On 16 October 1990, the additional profits tax assessments for the years of assessment 1981/82 to 1986/87 inclusive were revised based on the agreed discrepancies.
11. The following is a comparative table of the assessable profits before and after investigation and the calculation of the tax undercharged:

Year of Assessment	Assessable Profits Before Investigation	Assessable Profits After Investigation	Profits Understated	Tax Undercharged
\$	\$	\$	\$	\$
1981/82	201,027	310,770	109,743	24,878
1982/83	56,359	261,956	205,597	42,818
1983/84	76,769	758,326	681,557	109,847
1984/85	201,587	263,475	61,888	10,521
1985/86	317,765	1,196,482	878,717	149,381
1986/87	<u>399,948</u>	<u>558,100</u>	<u>158,152</u>	<u>26,886</u>
	<u>1,253,455</u>	<u>3,349,109</u>	<u>2,095,654</u>	<u>364,331</u>

12. The Commissioner of Inland Revenue was of the opinion that the Taxpayer had without reasonable excuse made incorrect profits tax returns for the years of assessment 1981/82 to 1986/87 inclusive in respect of the business. On 13 November 1990, he gave two notices to the Taxpayer that he proposed to assess the Taxpayer to additional tax by way of penalty in respect of the years of assessment 1981/82 to 1986/87 inclusive.
13. The Taxpayer made written representations to the Commissioner. On 23 January 1991 the Commissioner after taking into account the Taxpayer's representations issued notices of assessment of additional tax under section 82A of the Inland Revenue Ordinance for the years of assessment 1981/82 to 1986/87 inclusive in the following amounts:

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<u>Year of Assessment</u>	<u>Tax Undercharged</u> \$	<u>Amount of Additional Tax</u> \$	<u>Percentage of Penalty Tax</u> %
1981/82	24,878	32,000	129
1982/83	42,818	55,000	128
1983/84	109,847	140,000	127
1984/85	10,521	13,000	124
1985/86	149,381	179,000	120
1986/87	<u>26,886</u>	<u>30,000</u>	<u>112</u>
	<u>364,331</u>	<u>449,000</u>	123

14. On 18 February 1991 a notice of appeal against these section 82A penalty tax assessments was lodged with the Board of Review.

At the hearing of the appeal, the Taxpayer appeared by himself. He explained that the business has been established in 1981 and that until 1983 there had been six partners and that the business did not make very much profit. He said that in 1983, the four overseas partners had sold the business to him for only \$30,000 which supported his claim that the business had not made big profits. He said that after he had taken over the business in 1983, a fire had broken out in his home in 1984 and all of the account books of the business had been destroyed in the fire. He went on to say that last year he had closed the business. He said that he had of his own accord gone to the Inland Revenue Department in the hope of settling the case which had been dragging on for some time. He said that because all of the accounts had been destroyed for the period from 1981 to 1984 there was no point in his arguing over past accounts and that his purpose for appealing to the Board of Review was to have the penalties reduced or waived. He said that because the business had been closed, he could not afford to pay additional tax. He pointed out that his education level was very low.

The representative for the Commissioner submitted that the Taxpayer had not been fully cooperative in the course of the enquiry. He said that the present ability of the Taxpayer to pay the penalties was not a ground for reducing the quantum thereof. He drew our attention to three previous Board of Review decisions, namely,

D63/88, IRBRD, vol 4, 69
D69/89, IRBRD, vol 5, 67
D4/90, IRBRD, vol 5, 86

He said that the Taxpayer had agreed the assets betterment statement and had accepted the revised tax assessments based thereon. He said that the magnitude of the amount understated by the Taxpayer is a material factor when assessing penalties. He pointed out that it had been necessary to issue estimated assessments from time to time and that it was only after the estimated assessments had been issued and the Taxpayer had lodged objection thereto that the Taxpayer had offered any cooperation.

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As has now been stated by many Boards of Review, an appropriate penalty for someone who has failed in his obligations under the Inland Revenue Ordinance is a penalty of an amount equal to the tax undercharged. In each case, it is then necessary to decide whether the aggravating or mitigating circumstances merit an increase or a decrease of the amount of such penalties.

In the present case, the Commissioner has taken the view that the conduct of the Taxpayer and the magnitude of the understatement of profits is sufficient to merit an increase in the amount of the penalties. However, there is no allegation that the Taxpayer has intentionally evaded payment of tax or intentionally filed false returns. Indeed if such allegations were made we would expect to see this case referred to a court of criminal jurisdiction and not handled by way of administrative penalties.

We agree that the magnitude of the understatement is an aggravating circumstance. With regard to cooperation, the Taxpayer in the course of the hearing argued very strenuously that he had given full cooperation. We have some doubt about whether or not the Taxpayer could have given greater cooperation than he did and do not totally accept his submission that he was fully cooperative. Had he given total cooperation it would be a mitigating factor which might merit a reduction of the amount of the penalties. On the other hand, we do not feel that his level of cooperation would justify a substantial increase in the quantum of the penalties.

We have some sympathy for the Taxpayer who when he appeared before us said that he had a low level of education. He did not appear to us to be a man of great sophistication and the business ran by him did not appear to be a very sophisticated business. No challenge was made to his statement that all of the early accounting records of the business had been destroyed in a fire and we accept his submission in this regard as being true. The loss of accounting records clearly would place the Taxpayer at a substantial disadvantage.

Having taken into account all of the circumstances of this case, we are of the opinion that the penalties imposed by the Commissioner which amount to approximately 123% of the tax undercharged or 41% of the maximum permitted by the Inland Revenue Ordinance are excessive. In our opinion this case is no better and no worse than a number of other cases which have come before Boards of Review in which the appropriate penalty has been an amount equal to the amount of the tax undercharged. Accordingly we order that the penalties against which the Taxpayer has appealed should be reduced as follows:

<u>Year of Assessment</u>	<u>Reduced Penalty</u>
	\$
1981/82	24,878
1982/83	42,818
1983/84	109,847
1984/85	10,521

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1985/86	149,381
1986/87	<u>26,886</u>
Total	<u>364,331</u>