

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D50/01

**Penalty tax** – submission of incorrect tax returns and failure of filing any tax return for several years of assessment without reasonable excuse – gross dereliction of duty – finality of the assessable profits once agreement was reached between the parties – general starting point for incorrect returns was 100% of the tax undercharged – some weight must be given to the length of delay and the level of award as reflected in past decisions of this Board – penalty imposed ranges from 15% to 97% of the tax undercharged – section 82A of Inland Revenue Ordinance (‘IRO’).

Panel: Ronny Wong Fook Hum SC (chairman), Francis Lui Yiu Tung and Ng Yook Man.

Date of hearing: 7 April 2001.

Date of decision: 9 July 2001.

The taxpayer understated assessable profits for two years of assessment 1993/94 and 1994/95 and failed to file any tax return for three years of assessment between 1995/96 and 1998/99 even after repeated issuance of estimated assessments. The total amount of profits short returned was \$6,074,509. Mutual agreement was reached as to the amount of revised assessable profits for the respective years of assessment on 23 March 2000.

As a result, the Commissioner of Inland Revenue notified the taxpayer of his intention to impose additional tax due to:

1. His submission, without reasonable excuse, of incorrect returns for the years of assessment 1993/94 and 1994/1995.
2. His failure, without reasonable excuse, to file any tax return for three years of assessment between 1995/96 and 1998/99.

The taxpayer appealed against the additional tax, which ranges from 76% to 100% of the tax undercharged, so imposed.

#### **Held:**

1. The taxpayer did not have any reasonable excuse for the incorrect returns for the years of assessment 1993/94 and 1994/95 and the belated returns for the years of assessment 1995/96 to 1998/99.

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2. The Board accepted the submissions of the Revenue that the starting point for the former years must be the agreement of 23 March 2000 and the Board was not entitled to open up the finality of the assessments for those years on the basis of the agreement reached between the parties.
3. The physical conditions of the taxpayer's husband did not excuse the taxpayer's defaults. His health did not prevent the Company from making substantial profits in all the years in question. The taxpayer took no step to obtain proper advice until investigation by the Revenue.
4. As far as the issue of quantum of additional tax was concerned, the Board was of the view that the years of assessment 1993/94 and 1994/95 must stand on a different footing from the years of assessment 1995/96 to 1998/99, as the former years were related to incorrect returns whilst the latter years were related to late returns.
5. Whilst the Board agreed that the general starting point for incorrect returns was 100% of the tax undercharged, the Revenue had obviously not given any allowance for the years of assessment 1993/94 and 1994/95 as the additional tax imposed was 100% of the amount of tax undercharged. The Board was of the view that the Revenue erred in principle in not making any allowance for those years.
6. The Board was of the view that every encouragement should be given to taxpayers to settle their differences with the Revenue. Unless the fiscal position of the taxpayer in question was clearly beyond doubt so that no weight should be given to his concession, the taxpayer's readiness to bring his dispute with the Revenue to a speedy resolution must be given weight in assessing additional tax levied on the basis of his liability crystallised as a result of the compromise. In the circumstances, the Board was of the view that there should be a 30% deduction from the starting point and it would revise the assessments for the years of assessment 1993/94 and 1994/1995 to \$48,313 and \$101,645 accordingly.
7. The Board was not prepared to disturb the assessments for the years of assessments 1995/96 and 1996/97. This was a case of gross dereliction of duty. Whilst the assessments of the Commissioner for those years were on the high side, the Board did not see any error in principle given the length of the inordinate delay and the fact that no step was taken by the taxpayer to discharge her duties as a taxpayer until investigation by the Revenue.
8. As far as the years of assessment 1997/98 and 1998/99 were concerned, the periods of delay were about one and a half years and half a year. Whilst the Board

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recognised that the years of assessment 1997/98 and 1998/99 were part and parcel of the taxpayer's flagrant disregard of her obligations, the Board was of the view that some weight must be given to the length of delay and the level of award as reflected in past decisions of this Board. The Board was accordingly of the view that the additional tax for the year of assessment 1997/98 should be assessed at the rate of 40% and for the year of assessment 1998/99 at the rate of 15%: D25/97, IRBRD, vol 12, 204.

### **Appeal allowed in part.**

Case referred to:

D25/97, IRBRD, vol 12, 204

Yue Wai Kin for the Commissioner of Inland Revenue.

Lam Yiu Hoi Peter of Messrs Peter Y H Lam & Co for the taxpayer.

### **Decision:**

#### **Background**

1. On 18 May 1982, the Taxpayer registered a 'Medical Equipment' business in the name of Company A ('the Company') which she carried on in Kowloon.
2. By a return dated 22 March 1995, the Taxpayer reported to the Revenue her earnings for the year of assessment 1993/94. She asserted in that return that assessable profits which she obtained from the Company that year was \$256,624.
3. By an undated return which the Revenue received on 16 February 1996, the Taxpayer informed the Revenue that the assessable profits of the Company for the year of assessment 1994/95 was \$310,490.
4. Mr B is the husband of the Taxpayer. Commencing from about June 1996, Mr B regularly attended Hospital C for medical treatments. According to a medical certificate dated 14 August 2000, Mr B had been under treatment for impaired memory since 1998. He was also suffering from chronic mercury intoxication.
5. The Taxpayer did not file any tax return for the years of assessment 1995/96 to 1997/98 even after the repeated issuance of estimated assessments against her by the Revenue.

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6. On 23 September 1999, officers of the Revenue visited the Taxpayer and Mr B in their business premises. The Taxpayer and Mr B were then accompanied by their tax representatives. Officers of the Revenue informed the Taxpayer and Mr B that the Revenue would be conducting a tax audit on the Company. The officers also explained to them the relevant secrecy and penalty provisions.

7. On 30 November 1999, the Taxpayer submitted her returns for the years of assessment 1995/96 to 1998/99. She was seriously out of time in the submission of these returns.

<b>Year of assessment</b>	<b>Date of dispatch of return by the Revenue</b>	<b>Date when return submitted</b>	<b>Period of delay as alleged by the Revenue</b>	<b>Profits returned \$</b>
1995/96	1-5-1996	30-11-1999	1,217 days	1,423,469
1996/97	1-5-1997	30-11-1999	852 days	1,209,178
1997/98	1-5-1998	30-11-1999	487 days	1,416,866
1998/99	3-5-1999	30-11-1999	120 days	791,759

8. By letter dated 23 March 2000, the Taxpayer informed the Revenue of her acceptance that the Company's assessable profits for the years of assessment 1993/94 to 1998/99 were as follows:

<b>Year of assessment</b>	<b>Profits already returned \$</b>	<b>Agreed revised assessable profits \$</b>	<b>Profits short returned \$</b>
1993/94	256,624	632,504	375,880
1994/95	310,490	1,084,713	774,223
1995/96	0	1,423,469	1,423,469
1996/97	0	1,209,178	1,209,178
1997/98	0	1,500,000	1,500,000
1998/99	0	791,759	791,759
<b>Total:</b>	<b>567,114</b>	<b>6,641,623</b>	<b>6,074,509</b>

9. In her letter of 23 March 2000, the Taxpayer placed considerable emphasis on the following:

- (a) She was merely late in the submissions of her returns for the years of assessment 1995/96 to 1998/99. There was no understatement of profits for those years.
- (b) She agreed to the figures for the years of assessment 1993/94 and 1994/95 in a spirit of compromise so as to save time, energy and resources.

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10. By notice dated 19 July 2000, the Commissioner informed the Taxpayer of her intention to assess additional tax as the Taxpayer had, without reasonable excuse, made incorrect returns for the years of assessment 1993/94 and 1994/95 and had failed to comply with the requirements of section 51(1) of the IRO for the years of assessment 1995/96 to 1998/99. After considering representations on behalf of the Taxpayer dated 14 August 2000, the Commissioner by notice dated 26 September 2000, imposed additional tax in the following sums:

<b>Year of assessment</b>	<b>Tax undercharged</b> \$	<b>Additional tax assessed</b> \$	<b>Relationship between additional tax assessed and tax undercharged</b> %
1993/94	69,019	69,000	100
1994/95	145,208	145,000	100
1995/96	213,520	207,000	97
1996/97	181,376	142,000	78
1997/98	202,500	154,000	76
1998/99	101,511	79,000	78
<b>Total:</b>	<b>913,134</b>	<b>796,000</b>	<b>87</b>

### **The hearing before us**

11. The Taxpayer did not give any oral evidence before us. Mr Lam for the Taxpayer submitted for our consideration the following documents:

- (a) Receipts issued by Hospital C in relation to the treatments extended to Mr B.
- (b) Fee notes issued by an accounting firm, Company D, for the period between 16 October 1998 and 27 January 1999.

12. Mr Lam further submitted the following factors for our consideration:

- (a) The Taxpayer carried on a family business. Mr B was under constant medical attention. The Taxpayer was under considerable pressure looking after her husband and the business.
- (b) The Company did have an experienced accountant in the years 1993 to 1995. That accountant emigrated abroad and efforts by the Company to find a replacement were unsuccessful.
- (c) Little assistance was rendered by Company D.

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- (d) Mr Lam's firm was instructed on or about 9 September 1999. Immediate steps were taken to sort out the accounts of the Company.
- (e) The Taxpayer co-operated with the Revenue throughout its investigation.

13. The Revenue submitted that:

- (a) The Taxpayer should not be allowed to re-open the agreement reached on 23 March 2000.
- (b) It is no excuse for the Taxpayer to say that she relied upon her employees and they were not competent. It was her responsibility to secure that competent staff were employed. The fact that the Taxpayer had no accounting experience is immaterial. The Taxpayer's business operations were substantial and the Taxpayer should have hired competent staff.
- (c) The Taxpayer made no effort to submit any return since May 1996. The returns for the years of assessment 1995/96 to 1998/99 were only submitted after visit by the Revenue on 23 September 1999. Seven estimated assessments were sent to the Taxpayer between May 1996 and September 1999. The Taxpayer took no action despite those assessments.
- (d) The normal starting point for additional tax after investigation by the Revenue is 100% of the amount of tax that would have been undercharged. The Commissioner had made due allowance for the co-operation on the part of the Taxpayer.

### **Our decision**

14. The Taxpayer does not have any reasonable excuse for the incorrect returns for the years of assessment 1993/94 and 1994/95 and the belated returns for the years of assessment 1995/96 to 1998/99. We accept the submission of the Revenue that the starting point for the former years must be the agreement of 23 March 2000 and we are not entitled to open up the finality of the assessments for those years on the basis of the agreement reached between the parties. The physical conditions of Mr B do not excuse the Taxpayer's defaults. His health did not prevent the Company from making substantial profits in all the years in question. The Taxpayer took no step to obtain proper advice until investigation by the Revenue.

15. We turn to the issue of quantum. We are of the view that the years of assessment 1993/94 and 1994/95 must stand on a different footing from the years of assessment 1995/96 to 1998/99. As indicated by the Commissioner's notice dated 19 July 2000, additional tax for the

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former years was assessed on the basis of incorrect returns whereas additional tax for the latter years was assessed on the basis of late returns.

16. Whilst we agree that the general starting point for incorrect returns is 100% of the tax undercharged, the Revenue has obviously not given any allowance for the years of assessment 1993/94 and 1994/95 as the additional tax imposed is 100% of the amount of tax undercharged. We are of the view that the Revenue erred in principle in not making any allowance for those years. The Revenue's investigation commenced in about September 1999. The Taxpayer submitted to a compromise in respect of those years in late March 2000. The Revenue accepted that there was co-operation on the part of the Taxpayer throughout its investigation. We are of the view that every encouragement should be given to taxpayers to settle their differences with the Revenue. Unless the fiscal position of the taxpayer in question is clearly beyond doubt so that no weight should be given to his concession, the taxpayer's readiness to bring his dispute with the Revenue to a speedy resolution must be given weight in assessing additional tax levied on the basis of his liability crystallised as a result of the compromise. In the circumstances of this case, we are of the view that there should be a 30% deduction from the starting point and we would revise the assessments for the years of assessment 1993/94 and 1994/95 to \$48,313 (70% of \$69,019) and \$101,645 (70% of \$145,208).

17. In relation to the years of assessment 1995/96 to 1998/99:

- (a) We are not prepared to disturb the assessments for the years of assessment 1995/96 and 1996/97. This is a case of gross dereliction of duty. Whilst the assessments of the Commissioner for those years are on the high side, we do not see any error in principle given the length of the inordinate delay and the fact that no step was taken by the Taxpayer to discharge her duties as a taxpayer until investigation by the Revenue.
- (b) As far as the years of assessment 1997/98 and 1998/99 are concerned, the periods of delay are about one and a half years and half a year. In D25/97, IRBRD, vol 12, 204, the taxpayer was late in submitting his returns for three tax years. The periods of delay were 20 months and 24 days; 14 months and five days and three months and three days. The taxpayer had two previous transgressions. The Board affirmed assessments of additional tax on the basis of 17.4%; 16.12% and 10% of the tax undercharged. Whilst we recognise that the years of assessment 1997/98 and 1998/99 were part and parcel of the Taxpayer's flagrant disregard of her obligations, we are of the view that some weight must be given to the length of delay and the level of award as reflected in decisions of this Board. Bearing these factors in mind, we are of the view that the additional tax for the year of assessment 1997/98 should be assessed at \$81,000 (40% of \$202,500) and for the year of assessment 1998/99 at \$15,226 (15% of \$101,511).

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18. For these reasons, we allow the Taxpayer's appeal in part and revise the assessments in the manner indicated above.