Case No. D53/02

Penalty tax – submission of incorrect tax returns without reasonable excuse – substantial understatement both in actual amounts and in percentage terms – imposition of additional assessments at the average rate of 79.46% – a taxpayer could not rely on a practice note of the Revenue, when in fact he did not know about it at the time of furnishing his tax returns, as reason for understatement – applicability and coverage of the Departmental Interpretation and Practice Notes No 12 ('DIPN No 12') – wholly misconceived reliance by the appellant on DIPN No 12 – appeal was unmeritorious and an abuse of the process – penalized in costs – sections 9(1)(a), 68(4), 68(9), 82A and 82B(3) of the Inland Revenue Ordinance ('IRO').

Panel: Kenneth Kwok Hing Wai SC (chairman), Lawrence Lai Wai Chung and Anthony So Chun Kung.

Date of hearing: 1 August 2002.
Date of decision: 28 August 2002.

The appellant, a car sales representative for Company B before he joined Company A since 1 May 1994, appealed against the additional tax assessments raised on him under section 82A of the IRO for filing incorrect tax returns for the years of assessment 1994/95 to 1997/98.

The appellant's income received from Company A included basic salaries, sales commission and year end bonus. He also received similar remuneration from Company B except year end bonus.

In the course of his employment, the appellant was also required to refer customers to finance companies for obtaining hire purchase facilities, which entitled him to receive additional remuneration in the form of loan originating fee ('HP commission') from relevant Finance Companies C, D and E. The HP commission was paid either directly into the appellant's bank accounts or by cheque.

Apart from the said referrals for hire purchase facilities, the appellant was also required to refer customers for insurance coverage to Insurance Company H or two insurance companies of Group I, namely Insurance Company I1 and Insurance Company I2. Again, the appellant also received commission ('insurance commission') from the relevant insurance companies.

Upon comparing the tax returns filed by Companies A and B, Insurance Company I1, and that of the Taxpayer, the Revenue soon discovered that the appellant omitted to report

commissions he received from Finance Company C, Insurance Companies H, I1 and I2. Upon investigation by the Revenue, the appellant confirmed that he had omitted to report these commissions. The appellant provided explanations for such omission.

Further interview and negotiations between the appellant's representative and the Revenue had ensued for a total of 27 months before the appellant gave notice of appeal to the Board of Review against the additional tax assessments for the years of assessment 1994/95 to 1997/98. Additional tax at the average rate of 79.46%, including the years of assessment 1993/94 and 1998/99, of the tax undercharged was imposed against the appellant.

The grounds of appeal of the appellant were:

(a) He had a reasonable excuse in submitting the tax returns by omitting the commission income in question for the four years of assessment from 1994/95 to 1997/98. He was allowed by DIPN No 12 to remain anonymous.

(b) In the event that the Board was of the opinion that he did not have a reasonable excuse, he argued that the penalty (average 79.6% of tax undercharged) be substantially reduced because the penalty was excessive.

The facts appear sufficiently in the following judgment.

Held:

1. The onus of proving that the assessments are incorrect or excessive is on the appellant, sections 82B(3) and 68(4).

2. During the hearing, no reason was put forward as to why the appellant did not appeal against the additional tax assessments in respect of the years of assessment 1993/94 and 1998/99.

3. There was no evidence that the appellant knew anything about DIPN No 12 before he furnished his tax returns. There was also no evidence that the appellant in fact relied on this practice note when he filled in his tax returns. As the appellant did not know anything about this practice note, he could not have in fact relied on it when he understated his income.

4. The heading of DIPN No 12 is 'Commissions, Rebates and Discounts Payment of Illegal Commissions' and one had to pay attention in particular to the first two paragraphs of the first note dated 15 November 1960 addressed to all authorized representatives.

5. It seemed that DIPN No 12, headed 'illegal' commissions with the opening reference to 'squeeze monies', was dealing with bribery cases. There was no suggestion in this appeal of any bribery.

6. More importantly, the then Commissioner expressly stated that 'Neither does this arrangement relieve the recipient of these payments from his responsibility to return the amount for tax purposes'. It was nonsensical to suggest that this permitted the recipient not to return the amount.

7. The representative of the appellant conceded that the appellant did not have a reason to claim the excuse.

8. The wholly misconceived reliance by the appellant on DIPN No 12 had wasted the time and resources of the Board of Review and of the Revenue. Clearly, the appellant had no excuse to understate his income.

9. Far more time (that is, 27 months) was spent by the Revenue in investigating the present case than that in D103/01, IRBRD, vol 16, 837. It therefore justified higher penalty in this case than that imposed in D103/01, which involved only 19 months of investigation.

10. Contrary to the submission of the appellant's representative who argued that the appellant was 'most co-operative' during the investigation, the Board viewed that the appellant was more obstructive than co-operative.

11. It took 27 months before the appellant reached an overall compromise with the Revenue. The agreement dated 26 October 2001 was a one-and-a-half page (A4 size) three-paragraph document in Chinese and in English.

12. There was no evidence that the appellant misunderstood the agreement. Yet the appellant wasted everybody's time by trying to re-open it in correspondence and at the hearing of the appeal. The appellant wasted more of everybody's time by making the assertion that the expense allowance given to Company L's sales representatives was 20%.

13. The understatement was substantial, both in actual amounts and in percentage terms, and went on for a number of years. If the Commissioner erred at all, he erred in being too lenient.

14. The Board found none of the assessments was excessive and confirmed the assessments.

15. This appeal was frivolous and vexatious and an abuse of the process. Pursuant to sections 82B(3) and 68(9) of the IRO, the Board ordered the appellant to pay the sum of $5,000 as costs of the Board, which $5,000 shall be added to the tax charged and recovered therewith.

Appeal dismissed and a cost of $5,000 charged.

Cases referred to:

D3/82, IRBRD, vol 2, 1
D179/98, IRBRD, vol 14, 78
D113/95, IRBRD, vol 11, 248
D103/01, IRBRD, vol 16, 837
D53/88, IRBRD, vol 4, 10

Mei Yin for the Commissioner of Inland Revenue.
Wong Yun Tung of Messrs Peter Y C Lau & Co for the taxpayer.

Decision:

1. This is an appeal against the following additional assessments ('the Assessments') all dated 15 May 2002 by the Commissioner of Inland Revenue, assessing the Appellant to tax under section 82A of the IRO in the following sums:

Year of assessment	**Additional tax**	**Charge number**
	$	
1994/95	113,500	9-2959573-95-5
1995/96	181,300	9-4217879-96-6
1996/97	106,600	9-2577590-97-4
1997/98	74,300	9-3993549-98-1
Total	475,700	

The agreed facts

2. The parties have agreed the following facts and we find them as facts.

3. The Appellant has appealed against the additional tax assessments raised on him under section 82A of the IRO for filing incorrect tax returns - individuals for the years of assessment 1994/95 to 1997/98.

4. (a) The Appellant was employed by Company A as sales representative since 1 May 1994 and was responsible for selling new Company A's motor cars to customers. He was a sales representative of Company B, responsible for selling new Company B's motor cars, prior to his employment with Company A. The Appellant's income received from Company A included basic salaries, sales commission and year end bonus. He also received basic salaries and sales commission from Company B but with no year end bonus.

(b) In the course of his employment, the Appellant was also required to refer customers to finance companies for obtaining hire purchase facilities. According to the dealer's agreements signed between Company A and Finance Company C; and those signed by Company B with Finance Company D and Finance Company E respectively, the Appellant received loan originating fee ('HP commission') from Finance Companies C, D and E. The HP commission from Finance Companies C and E was paid directly into the Appellant's bank accounts held with Bank F and Bank G respectively. Finance Company D directly paid the HP commission to the Appellant by cheque.

(c) (i) Apart from the referrals for hire purchase facilities, the Appellant was also required to refer customers for insurance coverage to Insurance Company H or two insurance companies of Group I, namely Insurance Company I1 and Insurance Company I2. The Appellant also received commission ('insurance commission') from the aforesaid insurance companies.

(ii) During the period from 1994 to late 1997, the commission paid by Insurance Company H was made through its agent Company J to the Appellant. After that, Insurance Company H paid the insurance commission to the Appellant directly by cheque.

(iii) Insurance Companies I1 and I2 directly paid the insurance commission to the Appellant by cheque.

5. On divers dates, Companies A and B submitted the following employer's returns of remuneration and pensions ('Employer's Return') in respect of the Appellant for the years of assessment 1993/94 to 1998/99:

Submitted by	Year of assessment	Period covered	Total income $
Company B	1993/94	1-4-1993 – 31-3-1994	314,845
Company B	1994/95	1-4-1994 – 1-5-1994	26,910
Company A	1994/95	1-5-1994 – 31-3-1995	528,356
Company A	1995/96	1-4-1995 – 31-3-1996	767,755
Company A	1996/97	1-4-1996 – 31-3-1997	629,969
Company A	1997/98	1-4-1997 – 31-3-1998	737,829
Company A	1998/99	1-4-1998 – 31-3-1999	249,350

6. On divers dates, Insurance Company I1 submitted for the Appellant an employer's return for the year of assessment 1994/95 and a notification of remuneration paid to persons other than employees for the year of assessment 1995/96. The returns showed the following particulars:

Year of assessment	Commission income $	Date of signature
1994/95	3,054	30-4-1995
1995/96	25,173	10-5-1996

7. On divers dates, the Appellant submitted the following duly signed tax returns - individuals for the years of assessment 1993/94 to 1998/99:

Year of assessment	Assessable income $	Outgoings and expenses $	Date of signature
1993/94	314,845	44,000 [1]	16-5-1994
1994/95	528,356	86,000 [2]	5-5-1995
1995/96	767,755	75,000 [3]	6-5-1996
1996/97	629,969	73,000 [4]	7-5-1997
1997/98	737,829	86,550 [4]	5-5-1998
1998/99	249,350	40,000 [3]	26-5-1999

[1] Outgoings and expenses claimed included mobile telephone fee, transportation and entertainment.

[2] Outgoings and expenses claimed included car park fees, mobile phone fee and expenses for business.

[3] Outgoings and expenses claimed included mobile phone fee, car expenses and entertainment expenses.

[4] Outgoings and expenses claimed included mobile phone fee, car expenses, entertainment and miscellaneous expenses.

8. (a) The assessor raised on the Appellant the following salaries tax assessments:

Year of assessment	Assessable income	Outgoings and expenses [3]	Net assessable income	Date of issue
	$	$	$	
1993/94	314,845 [1]	29,414	285,431	16-12-1994
1994/95	555,266 [2]	40,460	514,806	16-10-1995
1995/96	767,755 [1]	62,760	704,995	4-11-1996
1996/97	629,969 [1]	50,610	579,359	12-9-1997
1997/98	737,829 [1]	57,740	680,089	12-11-1998

[1] Assessed in accordance with the tax return submitted by the Appellant.

[2] Assessed in accordance with the Employer's Return submitted by Companies A and B [paragraph 5].

[3] Equivalent to 10% of commission income.

(b) The Appellant did not object to the above salaries tax assessments.

9. (a) In early 1999, the Inland Revenue Department ('IRD') commenced an investigation into the tax affairs of motor car sales representatives. It was found that the sales representatives of Company A did not report the HP commissions they received from Finance Company C and the insurance commissions they received from Insurance Companies H and I2 during the relevant years of assessment.

(b) On divers dates, the assessor issued enquiry letters to Finance Company C, Insurance Companies H and I2. These companies confirmed in their replies that the following sums of HP and insurance commissions were paid to the Appellant:

Year of assessment	Finance Company C	Insurance Company I2	Insurance Company H
	$	$	$
1994/95	848,165	-	-
1995/96	1,060,263	72,623	253,528 [1]

1996/97	552,736	70,793	136,883 [1]
1997/98	423,411	122,821	161,097 [1]
1998/99	189,629	115,608	50,009
Total	3,074,204	381,845	601,517

[1] The commission was paid through Company J.

10. (a) On 15 July 1999, the Appellant attended an interview with the assessors. At the meeting, the Appellant confirmed that:

(i) He had been employed by Company A as a sales representative since 1 May 1994. Before then, he was employed by Company B as sales representative. Companies A and B were not associated companies.

(ii) During the employment with Company B, the Appellant only received commission and had fully reported his commission, including HP commission, in the tax returns.

(b) The Appellant also confirmed that he had omitted to report commission received from Finance Company C, Insurance Companies H, I1 and I2. The Appellant provided the following explanations for his omission:

(i) The staff of Finance Company C had told him that he was not required to report the HP commission to the IRD. Moreover, the Appellant's colleagues in Company A only reported their income from Company A but not the HP commission from Finance Company C.

(ii) Not until recently, when the Appellant's colleagues of Company A were invited to have meetings with the assessor one by one that he realised his obligation as a taxpayer in notifying the Commissioner of Inland Revenue about the receipt of chargeable income.

(c) According to the Appellant, he gave notice by fax to the IRD on 24 June 1999 that he had omitted to report in his tax return for the year of assessment 1998/99 the commissions received from Finance Company C and Insurance Company I2 in the respective sums of $180,000 and $115,608.

(d) The Appellant disclosed to the assessor that most of his commissions had been rebated to the customers in the form of car accessories. The assessor explained to the Appellant that deduction would be allowed for outgoings and expenses, other than expenses of domestic or private nature, wholly, exclusively and necessarily incurred in the production of the assessable income.

The assessor told the Appellant that under normal circumstances, deduction equivalent to 10% of the commission income received by sales representative would be allowed by concession. The Appellant claimed that the 10% deduction was grossly inadequate. He stated that for each motor car sold, he had kept documentary evidence and could submit the information to the IRD for checking. The assessors requested the Appellant to supply the supporting evidence within one month.

(e) On 21 October 1999, the assessor sent the note of interview to the Appellant for comment and confirmation. Upon receipt of the reminder of 27 January 2000, the Appellant submitted on 8 February 2000 the signed note of interview with some amendments.

11. (a) On 28 July 1999, the chief assessor received a letter from 29 sales representatives of Company A, including the Appellant. They put forward a proposal with following claims:

(i) A deduction of 30% of their income should be allowed in computing their net assessable income.

(ii) They claimed that they were misled by the relevant finance and insurance companies which promised to pay tax for their commission income and handle all the tax matters for them. The omission of HP and insurance commissions from their tax returns was not their fault, hence they should not be penalised.

(b) On the other hand, the 29 sales representatives intended to bring legal action against Finance Company C. They appointed Solicitors' Firm K to draft letter to Finance Company C challenging the breach of the oral agreement made in 1989 as the latter failed to pay tax for them and handle their tax matters. They also expressed their objection to Finance Company C's act of submitting to the IRD details of their commission income for the past six years. At the same time, they also requested Solicitor' Firm K to draft similar letter to Insurance Company I2. However, upon consideration of the possible pressure from their present employer, Company A, they did not send out the drafts and also gave up further action.

12. (a) On 26 August 1999, the chief assessor gave reply to the 29 sales representatives rejecting their claims. Regarding the deduction claim, the chief assessor requested them to submit a detailed breakdown of the expenditures with supporting evidence in support. The sales representatives were further advised that penalties were provided under Part XIV of the IRO and they

could not be waived. The Commissioner would consider penal actions after the assessments involved had become final and conclusive.

(b) Although repeated requests were made by the assessor, no information or supporting evidence was submitted by the Appellant or the other sales representatives.

13. On 14 September 1999, the assessor received a letter that the Appellant together with 20 sales representatives of Company A appointed Messrs Peter Y C Lau & Co, certified public accountants, as their representatives.

14. (a) On 17 September 1999, Messrs Peter Y C Lau & Co gave three letters to the assessor requesting for reconsideration and acceptance of the sales representatives' previous proposal [paragraph 11(a)].

(b) Messrs Peter Y C Lau & Co considered the proposal attractive to the IRD. It was claimed that:

(i) The sales representatives and Insurance Company I2 and Finance Company C maintained an employers/employees relationship. The two companies had verbally agreed to pay tax for the sales representatives. In the year of assessment 1995/96, Insurance Company I1 was replaced by Insurance Company I2 for the express purpose of paying net of tax insurance commissions to the sales representatives.

(ii) The sales representatives had sought clarification from Insurance Company I2 and Finance Company C concerning the income reporting requirements. The latter told them in unambiguous terms that the commissions did not need to be reported because tax on them had been settled.

15. On 21 September 1999, the assessor received another letter from Messrs Peter Y C Lau & Co. The latter considered that the Commissioner should invoke the treatment under DIPN No 12 'Commissions, Rebates and Discounts Payment of Illegal Commissions' by waiving the tax on commissions received by the sales representatives and disallowing deduction of the commissions to Insurance Company I2 and Finance Company C.

16. (a) By a letter of 14 October 1999, the assessor rejected the proposal offered by the sales representatives again [paragraph 11(a) and 14(a)]. The assessor disagreed with Messrs Peter Y C Lau & Co's arguments [paragraph 14(b) and 15] in the following terms:

(i) There was no evidence to support that there was a written or verbal agreement between the sales representatives and Insurance Company I2 and Finance Company C respectively. Even if there was such an agreement, it would be a personal matter between them. Moreover, the incomes received by the sales representatives were derived from their employment with Company A and were taxable by virtue of section 9(1)(a) of the IRO. Their accountability did not depend on whether the payers agreed to pay the tax or not. The sales representatives, as the recipients, were statutorily required to disclose the incomes in their returns and pay for the tax. In addition, there was no statutory provision in Hong Kong for deduction of tax at sources for those incomes received by the sales representatives.

(ii) DIPN No 12 was intended to target on those cases where the payers on the one hand refused to provide information about the recipients and on the other hand claimed for deduction of the commission payments in their accounts. That practice note was not served as a machinery of collection to recover the tax payable by the recipients from the payers. The assessor did not agree that the Commissioner has to invoke the treatment under DIPN No 12 in the investigation on the tax affairs of the sales representatives.

(b) The assessor also attached with the letter schedules of total income for the years of assessment 1993/94 to 1998/99 for confirmation by the 21 sales representatives (including the Appellant). The schedules were prepared and based on the information available at that time. The assessor requested the sales representatives to check and confirm if the information given in the statement was true and complete. If any of them had received any income including commission, loan originating fee, rebate, etc from other finance company(ies) and/or other insurance company(ies) and/or other person(s) during the aforesaid years of assessment, they were required to provide the details.

17. (a) On 28 October 1999, Messrs Peter Y C Lau & Co in their letter gave the following comments on the assessor's letter of 14 October 1999 [paragraph 16(a)]:

(i) There was evidence to show that verbal agreements existed between the sales representatives and Finance Company C, Insurance Companies H and I2. Messrs Peter Y C Lau & Co considered that the sales representatives received ex-tax incomes and the IRO did not say that net of tax income was taxable. Regarding the statutory requirement

to report the commissions received from finance and insurance companies, Messrs Peter Y C Lau & Co claimed that Finance Company C, as the recipient of the tax portions of the commission, was statutorily required to disclose the income in its profits tax returns and pay for the tax.

(ii) Messrs Peter Y C Lau & Co did not agree to the assessor's interpretation of DIPN No 12 and made a detailed analysis of his own interpretation of the note.

(b) On the same date, Messrs Peter Y C Lau & Co submitted the confirmed schedule of income for the Appellant [paragraph 16(b)]. The Appellant stated in the schedule that income from Finance Company C, Insurance Companies H and I2, and Company J up to the year of assessment 1997/98 was net of tax. It was also stated that there might be additional income but it would be small and the Appellant could not remember the exact amount.

18. (a) On 6 October 1999 and 12 October 1999, the assessor issued enquiries to Companies A and J, Finance Company C and Insurance Company I2 requesting them to confirm if there was any written or verbal agreement on the payment of tax on the incomes received by the sales representatives of Company A.

(b) On divers dates, the above companies gave replies to the assessor and denied having any agreement with the sales representatives of Company A agreeing to pay tax for them.

19. (a) By a letter of 3 November 1999, the assessor wrote to Messrs Peter Y C Lau & Co and requested the Appellant to provide an estimate of the amount of additional income other than those stated in the schedule of income [paragraph 17(b)] in each of the years of assessment from 1993/94 to 1998/99, together with supporting computation showing how the estimate was arrived at.

(b) On 3 December 1999, the Appellant through Messrs Peter Y C Lau & Co gave reply to the assessor. The Appellant estimated that the total amount of additional income other than those stated in the schedule of income [paragraph 17(b)] for each of the years of assessment from 1993/94 to 1998/99 was around $20,000 to $30,000. However, he had no record of the exact amount.

20. (a) On 21 December 1999, based on the confirmed schedule of income [paragraph 17(b)], the assessor issued the additional salaries tax assessments for the years of assessment 1994/95 to 1997/98 and the salaries tax

assessment for the year of assessment 1998/99 to the Appellant. The assessments showed the following particulars:

Year of assessment	Additional assessable income	Additional outgoings and expenses	Additional Net assessable income
	$	$	$
1994/95	851,219	100,189	751,030
1995/96	1,412,127	155,228	1,256,899
1996/97	760,412	88,428	671,984
1997/98	707,329	86,776	620,553

Year of assessment	Assessable income	Outgoings and expenses	Net assessable income
	$	$	$
1998/99	604,596	60,460	544,136

(b) The Appellant did not object to the salaries tax assessment for the year of assessment 1998/99. By a letter of 19 January 2000, the Appellant through Messrs Peter Y C Lau & Co lodged objection against the additional salaries tax assessments for the years of assessment 1994/95 to 1997/98 on the ground of excessive assessments. Messrs Peter Y C Lau & Co claimed that the tax on commissions from Finance Company C and Insurance Company I2 were borne by the payers under contract. Since tax had been paid by the payers, the commission income should not be taxed again.

21. (a) On 31 January 2000, the assessor raised on the Appellant the following additional salaries tax assessment for the year of assessment 1993/94 in accordance with the information provided by Finance Company D:

Year of assessment	Additional assessable income
	$
1993/94	227,467

(b) By a letter of 3 February 2000, the Appellant lodged objection against the above assessment on the ground of excessive assessment. He claimed that:

(i) He did not have details of the income.

(ii) He expected a 10% deduction to be allowed in computing the net assessable income.

(c) On 16 March 2000, the assessor provided details of the income of $227,467 to the Appellant.

22. (a) On divers dates, the assessor received replies from various finance companies and motor car dealers in response to his previous enquiries. On examination of the Appellant's sales records provided by Company A with the above information, the assessor found that there were many cars sold through the Appellant which were referred for hire purchase facilities through other motor car dealers. The latter included Motor Car Dealer 1, Motor Car Dealer 2, Motor Car Dealer 3, Motor Car Dealer 4, Motor Car Dealer 5, Motor Car Dealer 6, Motor Car Dealer 7, Motor Car Dealer 8, Motor Car Dealer 9, Motor Car Dealer 10, Motor Car Dealer 11, Motor Car Dealer 12, Motor Car Dealer 13, Motor Car Dealer 14, Motor Car Dealer 15, Motor Car Dealer 16, Motor Car Dealer 17, Motor Car Dealer 18 and Motor Car Dealer 19.

(b) On 22 October 2001, the assessor faxed the above information to the Appellant and requested the latter to confirm if he had received commission from those transactions.

23. (a) On 26 October 2001, the Appellant attended an interview with the assessors. At the interview, the assessor gave the Appellant a schedule from Finance Company E showing that commission of $31,945.7 was paid to him in the year of assessment 1993/94. The Appellant submitted to the assessor the two schedules, with his comments, previously faxed to him [paragraph 22(b)]. The Appellant confirmed that:

(i) He had received commission from Finance Company E.

(ii) Among the various motor car dealers mentioned in paragraph 22(a), he had only received commission of $17,550 and $74,315 from Motors Car Dealers 4 and 16 respectively.

(b) The assessors found that there was a typing mistake on the schedule of total income [paragraph 16(b) and 17(b)]. The commission from Insurance Company I1 in the year of assessment 1995/96 should be $25,173 rather than $25,713. The results of the investigation were summarised as follows:

1993/94	**1994/95**	**1995/96**	**1996/97**	**1997/98**	**1998/99**	**Total**
$	$	$	$	$	$	$

Income assessed:							
Company B	314,845	26,910					341,755
Company A		528,356	767,755	629,969	737,829	249,350	2,913,259
	314,845	555,266	767,755	629,969	737,829	249,350	3,255,014
Income understated:							
Insurance Company I1		3,054	25,173				28,227
Finance Company C		848,165	1,060,263	552,736	423,411	189,629	3,074,204
Insurance Company I2			72,623	70,793	122,821	115,608	381,845
Insurance Company H			253,528	136,883	161,097	50,009	601,517
Finance Company D	227,467						227,467
Finance Company E	31,945						31,945
Motor Car Dealer 16			32,760	41,555			74,315
Motor Car Dealer 4			17,550				17,550
	259,412	851,219	1,461,897	801,967	707,329	355,246	4,437,070
Assessable income	574,257	1,406,485	2,229,652	1,431,936	1,445,158	604,596	7,692,084

(c) The Appellant agreed to settle the investigation for the years of assessment 1993/94 to 1998/99 with the above-mentioned assessable income. In computing the net assessable income, the Appellant agreed that a deduction of 10% of the total income to be allowed as outgoings and expenses.

(d) The Appellant signed on the spot the revised schedule of total income and a proposed settlement agreement of the net assessable income for the years of assessment 1993/94 to 1998/99. Before the Appellant indicated his acceptance of the basis of settlement by signing on the proposed settlement agreement ('the Agreement'), the assessor reminded him that the acceptance of the above-mentioned assessable income did not conclude the whole matter and that the case would be put up to the Commissioner or Deputy Commissioner for consideration of the penal actions under Part XIV of the IRO.

(e) On 30 October 2001, the assessor sent the note of interview to the Appellant for comment and confirmation.

24. On 6 November 2001, revised additional salaries tax assessments for the years of assessment 1993/94, 1995/96 and 1996/97 were issued to the Appellant based on the Agreement.

25. The Appellant's assessable income before and after investigation and the amount of tax undercharged in consequence of the Appellant's submission of incorrect tax returns - individuals are as follows:

Year of assessment	**Assessable income before investigation**	**Assessable income after investigation**	**Income understated**	**Tax undercharged**

	$	$	$	$
1993/94	314,845	574,257	259,412	51,450
1994/95	555,266	1,406,485	851,219	131,628
1995/96	767,755	2,229,652	1,461,897	213,026
1996/97	629,969	1,431,936	801,967	141,226
1997/98	737,829	1,445,158	707,329	111,699
1998/99	249,350	604,596	355,246	19,783
	3,255,014	7,692,084	4,437,070	668,812

The percentage of income understated to the total income assessed after investigation is 57.68%.

26. By a notice under section 82A(4) of the IRO dated 10 January 2002, the Commissioner informed the Appellant of his intention to assess additional tax in respect of his filing incorrect returns for the years of assessment 1993/94 to 1998/99. The Appellant was also informed that he had the right to submit written representations with regard to the proposed assessment of additional tax.

27. Upon receipt of the reminder of 7 January 2002 for the confirmation of the note of interview [paragraph 23(e)], the Appellant gave a letter dated 18 January 2002 to the assessor claiming that he had been misled in signing the Agreement. He alleged that he did not propose the 10% deduction and did not agree the payment of tax on the omitted income.

28. On 4 February 2002, the acting senior assessor gave a reply to the Appellant's letter of 18 January 2002. She explained to the Appellant that:

(a) The claim of deduction of outgoings and expenses was governed by section 12(1)(a) of the IRO. In the absence of any supporting evidence, the IRD would, by concession, allow deduction of outgoings and expenses to the extent of 10% of the commission income received by the sales representatives. However, if the sales representative claimed deduction in excess of the limit, he/she was required to supply documentary evidence. The acting senior assessor also drew the attention of the Appellant that during the course of the investigation, he had never supplied any documentary evidence despite his claim of full record kept [paragraph 10(d)]. On the other hand, the Appellant had no objection to the 10% deduction given in the salaries tax assessment for the year of assessment 1998/99 [paragraph 20], and made a deduction claim of 10% in his objection letter against the additional salaries tax assessment in the year of assessment 1993/94 [paragraph 21(b)]. Pursuant to the Agreement for settlement of the objections for the years of assessment 1993/94 to 1997/98 made on 26 October 2001, the revised assessments issued on 6 November 2001 were made under section 64(3) of the IRO and have become final and conclusive under section 70 of the IRO. The Appellant

did not dispute these revised assessments but utilised the tax reserve certificates previously purchased as a result of the objection lodged for settlement of the revised assessments. Thus, she considered that the Appellant only disputed the penalty issue rather than the amount of net assessable income.

(b) Paragraph 3 of the Agreement stated that the acceptance of the above-mentioned assessable income does not conclude the whole matter and that the case will be put up to the Commissioner or Deputy Commissioner for consideration of penal actions under Part XIV of the IRO, which include prosecution, compounding or imposition of additional tax. If additional tax is imposed, the maximum amount could be treble the amount of the tax undercharged. The acting senior assessor further explained that a copy of the Agreement was given during the interview to the Appellant for record purposes, she could not understand how the Appellant was misled.

29. (a) By a letter dated 8 February 2002, Messrs Peter Y C Lau & Co claimed that it has been stated in his letter of 19 November 2001 that the Appellant accepted the revised additional assessments for the years of assessment 1993/94 to 1997/98 but he would only withdraw his objection against the additional assessments for the years of assessment 1994/95 to 1997/98 if no penalty would be imposed.

(b) On 18 February 2002, the acting senior assessor rebutted the above allegation by drawing the attention of Messrs Peter Y C Lau & Co to the wordings of the Agreement and the provisions of the IRO especially sections 64 and 70.

30. (a) By a letter dated 22 February 2002, the Appellant reiterated that the Agreement was signed as a result of his misunderstanding. The details were stated in his letter of 18 January 2002 [paragraph 27]. In the letter of 19 November 2001, he still had objection against the assessment on the incomes from Finance Company C and Insurance Company I2 [paragraph 29(a)]. However, no positive response was received from the IRD.

(b) On 22 March 2002, the acting senior assessor wrote to the Appellant and stated that detailed explanations had already been given in her letters of 4 February 2002 [paragraph 28] and 18 February 2002 [paragraph 29(b)]. On the other hand, she reminded the Appellant that the notice under section 82A(4) had been issued to him for more than two months but no response was received. The Appellant was requested to submit his representations within ten days from the date of the letter, otherwise he would be regarded as giving up his right to make written representations to the Commissioner.

31. On 27 March 2002, the appellant through Messrs Peter Y C Lau & Co submitted representations to the Commissioner. Having considered and taken into account of the Appellant's representations, the Commissioner issued on 15 May 2002 the following notices of assessment and demand for additional tax under section 82A of the IRO:

Year of assessment	**Tax undercharged**	**Section 82A additional tax**	**Additional tax as percentage of tax undercharged**
	$	$	%
1993/94	51,450	44,300	86.10
1994/95	131,628	113,500	86.22
1995/96	213,026	181,300	85.10
1996/97	141,226	106,600	75.48
1997/98	111,699	74,300	66.51
1998/99	19,783	11,500	58.13
	668,812	531,500	79.46

32. By a letter dated 3 June 2002, the Appellant through Messrs Peter Y C Lau & Co gave notice of appeal to the Board of Review against the additional tax assessments for the years of assessment 1994/95 to 1997/98.

The appeal hearing

33. The grounds of appeal put forward by Messrs Peter Y C Lau & Co on behalf of the Appellant were as follows:

> '1. [The Appellant] had a reasonable excuse in submitting the tax returns by omitting the commission income in question, for the 4 years from 1994/95 through 1997/98. He was allowed by DIPN No. 12 to remain anonymous.
>
> 2. In the event that the Board is of the opinion that [the Appellant] did not have a reasonable excuse, we entreat that the penalty (average 79.60% on tax underpayment) be substantially reduced because the penalty is excessive.'

34. At the hearing of the appeal, the Appellant was represented by Mr Wong Yun-tung of Messrs Peter Y C Lau & Co and the Respondent was represented by Ms Mei Yin.

35. Ms Mei Yin did not call any witness. Mr Wong Yun-tung told us before he began his submission that he was not calling any witness. When he started to make factual assertions in his submission, he was asked where the evidence was. After conceding that there was no evidence he

asked for permission to call the Appellant. Ms Mei Yin had no objection and Mr Wong Yun-tung called the Appellant to give evidence.

36. Mr Wong Yun-tung did not cite any authority.

37. Ms Mei Yin cited:

(a) D3/82, IRBRD, vol 2, 1;

(b) D179/98, IRBRD, vol 14, 78;

(c) D113/95, IRBRD, vol 11, 248;

(d) D103/01, IRBRD, vol 16, 837; and

(e) D53/88, IRBRD, vol 4, 10.

Our decision

38. The onus of proving that the Assessments are incorrect or excessive is on the Appellant, sections 82B(3) and 68(4).

39. Mr Wong Yun-tung has not told us why the Appellant did not appeal against the additional tax assessments in respect of the years of assessment 1993/94 and 1998/99.

DIPN No 12 as reasonable excuse

40. There was no evidence that the Appellant knew anything about this practice note before he furnished his tax returns. There was also no evidence that the Appellant in fact relied on this practice note when he filled in his tax returns. As the Appellant did not know anything about this practice note, he could not have in fact relied on it when he understated his income.

41. Mr Wong Yun-tung contended that this was a matter of law and formulated the following proposition of law:

> 'Under law modified by departmental interpretation practice note number 12 recipients of commission have a choice to remain anonymous.'

42. Mr Wong Yun-tung's proposition needs only be stated to be rejected.

43. In response to the question on the relevance of the choice if the recipient did not know the choice existed, Mr Wong Yun-tung replaced the word 'choice' by 'right'.

44. In answer to the question whether the Commissioner had the power to 'modify' the law, Mr Wong Yun-tung said 'no'.

45. The heading of DIPN No 12 is 'Commissions, Rebates and Discounts Payment of Illegal Commissions' and the first two paragraphs of the first note dated 15 November 1960 addressed to all authorised representatives read as follows:

> *' It has long been known to me that a considerable amount of business in Hong Kong is transacted with the aid of commissions, rebates or discounts (commonly known as "squeeze") usually paid to persons, who for obvious reasons, prefer to remain anonymous.*
>
> *The consequences of these transactions on the revenue is obvious and it has recently been most forcibly brought to my notice when a firm in Hong Kong was unable to return the names and addresses of recipients of such payments, but were prepared instead to pay tax on them so that the revenue would be protected. This arrangement does not provide a satisfactory or complete answer to the problem but is accepted as a compromise more convenient to the business concerned. Neither does this arrangement relieve the recipient of these payments from his responsibility to return the amount for tax purposes.'*

46. It seems to us that DIPN No 12, headed 'illegal' commissions with the opening reference to 'squeeze monies', was dealing with bribery cases. There is no suggestion in this appeal of any bribery.

47. More importantly, the then Commissioner expressly stated that:

> *' Neither does this arrangement relieve the recipient of these payments from his responsibility to return the amount for tax purposes.'*

It is nonsensical to suggest that this permitted the recipient not to return the amount.

48. Mr Wong Yun-tung conceded that:

> ' I think we don't have a reason to claim the excuse.'

49. The wholly misconceived reliance by the Appellant on DIPN No 12 has wasted the time and resources of the Board of Review and of the IRD. Clearly, the Appellant has no excuse to understate his income.

Whether excessive

50. D103/01 was the decision of the Board, differently constituted, on an appeal from a colleague of the Appellant at Company A. The Board there upheld additional tax at the average rate of 65.79% of the tax undercharged.

51. The average in this appeal, including the years of assessment 1993/94 and 1998/99, is 79.46%.

52. There is at least one material difference between D103/01 and this case. In view of this material difference, the higher penalty in this case is in our decision quite justified.

(a) In D103/01, the first interview was on 22 June 1999 [paragraph 4] and the overall compromise agreement was on 22 January 2001 [paragraph 12]. Thus the investigation was concluded in 19 months.

(b) In this case, the first interview was on 15 July 1999 [paragraph 10(a)] and the overall compromise agreement was on 26 October 2001 [paragraph 23(a)]. Thus the investigation was concluded in 27 months.

53. Mr Wong Yun-tung claimed that the Appellant was 'most co-operative' during the investigation. In our decision, the Appellant was more obstructive than co-operative. It took 27 months before the Appellant reached an overall compromise with the IRD. The Agreement dated 26 October 2001 is a one-and-a-half page (A4 size) three-paragraph document in Chinese and in English. There is no evidence that the Appellant misunderstood the Agreement. Yet the Appellant wasted everybody's time by trying to re-open it in correspondence and at the hearing of the appeal. The Appellant wasted more of everybody's time by making the assertion that the expense allowance given to Company L's sales representatives was 20%.

54. The understatement is substantial, both in actual amounts and in percentage terms, and went on for a number of years. If the Commissioner erred at all, he erred in being too lenient.

55. In our decision, none of the Assessments is excessive. We have arrived at our decision without expressing any view on the penalty policy of the Respondent.

Disposition

56. We dismiss the appeal and confirm the Assessments.

Costs order

57. We are of the opinion that this appeal is frivolous and vexatious and an abuse of the process. Pursuant to sections 82B(3) and 68(9) of the IRO, we order the Appellant to pay the sum

of $5,000 as costs of the Board, which $5,000 shall be added to the tax charged and recovered therewith.