

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D54/88

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

Panel: William Turnbull (chairman), Christopher Chan Cheuk and Benjamin Kwok Chi Bun.

Date of hearing: 20 September 1988.

Date of decision: 1 December 1988.

The taxpayer carried on business as a Chinese herbalist. During the course of six years, the taxpayer understated his income by an average of 36%. After an investigation by the IRD, during which the taxpayer confirmed the substantial correctness of his previous returns, the discrepancy was assessed.

In addition, the Commissioner assessed penalties equal to an average of 32.2% of the maxima permitted. The taxpayer appealed.

Held:

The penalties were not excessive.

In cases of this nature, where a taxpayer over a number of years has failed to keep proper accounts and file correct returns, an appropriate penalty is the amount of tax undercharged (or 33.3% of the maximum permitted).

Appeal dismissed.

Lam Wai Ming for the Commissioner of Inland Revenue.

Stanley So of Stanley So & Co for the taxpayer.

Decision:

This is an appeal against a number of section 82A penalty tax additional assessments. The grounds of appeal are that the amounts of the penalties are in excess of that permitted by law and are excessive in the circumstances. The facts are as follows:

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1. The Taxpayer is an individual who carried on business as a Chinese herbalist.
2. During the years of assessment 1979/80 to 1984/85, the Taxpayer received consultation fees for his services as a Chinese herbalist.
3. On various dates, the Taxpayer submitted profits tax returns for the years of assessment 1979/80 to 1983/84 and the assessor raised profits tax assessments for those years based on the profits of the Taxpayer as they had been returned in the Taxpayer's tax returns.
4. In 1984, the assessor commenced an investigation of the tax affairs of the Taxpayer and, in a letter dated 7 November 1984, the accountants for the Taxpayer wrote to the assessor as follows:
 

‘ there is no omission or understatement in the tax returns previously submitted. As a Chinese herbalist, he has no knowledge to keep the complete accounting records for his business income and expenditure. Everyday, after he finished his work, he just counted how much was left in the drawer and considered this as his daily business income. However, in our client's opinion, the figures stated in the returns previously submitted should be very close to the fact.’
5. In the course of or as part of the inquiries made by the assessor, a question arose as to whether or not the rental income from certain property owned by the Taxpayer should be included in his business profits. In due course, it was agreed by the Taxpayer and the assessor that the rental income should be included in the business profits. In May 1985, additional assessments for the years of assessment 1979/80 to 1983/84 were issued which included this rental income.
6. On 17 March 1986, the Taxpayer submitted a profits tax return for 1984/85 declaring assessable profits of \$105,366 in respect of his business.
7. On 19 March 1986, the Taxpayer was interviewed and said that his records and returns might be incorrect but the discrepancy would be small.
8. On 24 April 1986, the accountants for the Taxpayer submitted revised certified accounts on behalf of the Taxpayer for the years of assessment 1979/80 to 1984/85 which showed that the consultation fees reported in the previous profits tax returns had been understated as follows:

<u>Year of Assessment</u>	<u>Fees per Original Accounts</u>	<u>Fees per Revised Accounts</u>	<u>Understatement of Fees</u>
	\$	\$	\$

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1979/80	80,242	115,242	35,000
1980/81	74,988	131,988	57,000
1981/82	92,536	153,536	61,000
1982/83	106,734	164,734	58,000
1983/84	108,748	168,248	59,500
1984/85	<u>114,768</u>	<u>171,768</u>	<u>57,000</u>
	<u>578,016</u>	<u>905,516</u>	<u>327,500</u>

9. Based upon these revised accounts, the assessor raised further assessments to tax for the years of assessment 1979/80 to 1984/85 which brought into account the additional consultation fees which the Taxpayer had now disclosed.
10. On 4 March 1987, due notice was given to the Taxpayer that it was proposed to impose penalties under section 82A of the Inland Revenue Ordinance. After receiving written representations from the accountants of the Taxpayer, the Deputy Commissioner on 24 April 1984 assessed additional tax by way of penalty under section 82A as follows:

<u>Year of Assessment</u>	<u>Section 82A Additional Tax</u>
1979/80	\$8,000
1980/81	\$14,000
1981/82	\$15,000
1982/83	\$12,000
1983/84	\$14,000
1984/85	\$14,000

11. The Taxpayer appealed against the section 82A assessments on two grounds, namely that the amounts exceeded those permitted and that the amounts were excessive in the circumstances.

At the hearing of the appeal, the representative for the Taxpayer informed the Board that the first ground of appeal was interrelated with an appeal by the Taxpayer against a refusal by the Commissioner to correct the tax assessments imposed upon the Taxpayer for the years 1979/80 to 1984/85. The representative explained that application had been made under section 70A of the Inland Revenue Ordinance to amend the tax assessments to exclude the rental income which the Taxpayer had received (see fact 5 above). He said that the first ground of appeal was that the section 82A penalties would exceed the maximum permitted if this other appeal were successful.

The representative submitted that, if the Taxpayer was unsuccessful in his appeal with regard to the application under section 70A, then the first part of his appeal

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against the section 82A assessments would fail and the Taxpayer's appeal would then be confined to whether or not the assessments appealed against were excessive in the circumstances.

The representative for the Commissioner drew attention to the facts that, when imposing the penalties, the Commissioner did so only in respect of the unreported consultation fees which the Taxpayer had received and had failed to include in his original tax returns and the Commissioner had not taken any account of the rental income. The representative for the Commissioner submitted that, in the circumstances the penalties imposed were not excessive and should be upheld.

We find no merit in the first ground of appeal. The amount of the penalties do not exceed the maximum amount to which the Taxpayer could be liable under section 82A. The maximum liability to tax is three times the amount of tax undercharged. The consultation fees understated are set out in fact 8 above and the amounts of tax undercharged and the maximum penalties which could be imposed are as follows:

<u>Year of Assessment</u>	<u>Tax Undercharged</u> \$	<u>Maximum Amount of Penalty</u> \$	<u>Additional Tax as percentage of Maximum Penalty</u> %
1979/80	8,750	26,250	30.5
1980/81	14,250	42,750	32.7
1981/82	15,250	45,750	32.8
1982/83	12,575	37,725	31.8
1983/84	14,730	44,190	31.7
1984/85	<u>14,250</u>	<u>42,750</u>	<u>32.7</u>
	<u>\$79,805</u>	<u>\$239,415</u>	<u>32.2%</u>

These maximum penalties are based entirely upon the tax undercharged in relation to the understatement of consultation fees. The dispute regarding the rental income is not material. However, we place on record that the Taxpayer's other appeal relating to the section 70A application was unsuccessful. [Editor's note; see D55/88, reported elsewhere in this volume.]

With regard to whether or not the amounts of the penalties are excessive in the circumstances, we again dismiss this appeal. The Taxpayer under-declared his taxable business income. If the assessor had not investigated his affairs, he would have paid substantially less tax than he was liable to pay. He was asked to confirm the amounts declared as being correct and his accountant replied that he did not keep proper accounts but that, in the Taxpayer's opinion, the amounts which he had declared should be close to the true amount. In fact, the amounts were substantially less than the true amounts.

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In cases of this nature, previous Boards of Review have stated that an appropriate penalty where a taxpayer over a number of years has failed to keep proper accounts and has failed to file correct tax returns is a sum approximately equal to the amount of the tax underpaid or one-third of the maximum permitted. In the present case, the total amount of the penalties is \$77,000 which is slightly less than the total amount of the tax undercharged and approximately one-third of the maximum permitted penalties. In such circumstances, we find that the amounts of the penalties are not excessive and we dismiss the appeal.