

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D56/88

Penalty assessment – whether penalty excessive – statement of relevant criteria: taxpayer's sophistication, cooperation and wilfulness – s 82A of the Inland Revenue Ordinance.

Panel: T J Gregory (chairman), Gordon M Macwhinnie and David A Morris.

Date of hearing: 14 September 1988.

Date of decision: 1 December 1988.

The taxpayer carried on business as a publisher. He submitted returns over the course of six years which substantially understated his true profits. After a three year investigation by the IRD, additional assessments were issued.

In addition, the Commissioner assessed the taxpayer to penalties which were equal to an average of 42.5% of the maxima permitted.

The taxpayer appealed. He explained that his deceased wife had been responsible for preparing the accounts of the business, that he was in poor health, and that he was in a perilous financial condition.

The Board found that the taxpayer was a sophisticated person as evidenced by the facts that his business required planning and maintenance of business contacts and that he had been in business for 16 years. He knew the true financial position of his business and he was aware of his obligations under the tax laws. He deliberately excluded income from his tax returns. He did not cooperate with the IRD's investigation into his affairs (as evidenced by the fact that the investigation took three years to complete).

Held:

The penalties were not excessive.

- (a) In assessing penalties, relevant factors are the taxpayer's cooperation, his sophistication, the sophistication of his business, and the extent to which he deliberately concealed profits. Also relevant here was the period during which the tax remained outstanding.
- (b) In assessing penalties, the comparatively small sum of tax involved is not relevant.

## INLAND REVENUE BOARD OF REVIEW DECISIONS

Case referred to:

D58/87, IRBRD, vol 3, 11

Raymond Ng for the Commissioner of Inland Revenue.  
The taxpayer appeared in person.

Decision:

### 1. THE NATURE OF THE APPEAL

The Taxpayer appealed to the Board of Review against assessments for additional tax levied by the Commissioner of Inland Revenue pursuant to section 82A of the Inland Revenue Ordinance in respect of incorrect profits tax returns for the years of assessment 1976/77 to 1979/80, both inclusive.

### 2. THE FACTS

2.1 The Taxpayer was the sole proprietor of a publication firm which commenced business in 1960. From the commencement of business in 1960 until 1984, the Taxpayer published, inter alia, a trade directory about Hong Kong products.

2.2 For the years of assessment to which the appeal relates, the returns filed by the Taxpayer were as follows:

| <u>Year of Assessment</u> | <u>Date of Filing</u> | <u>Period of Account</u><br>(year ended) | <u>Profit Returned</u><br>\$ |
|---------------------------|-----------------------|--|------------------------------|
| 1976/77                   | 4-10-1977             | 31-3-1977                                | 27,531.71                    |
| 1977/78                   | 21-12-1978            | 31-3-1978                                | 36,864.91                    |
| 1978/79                   | 15-10-1979            | 31-3-1979                                | 30,199.95                    |
| 1979/80                   | 28-10-1980            | 31-3-1980                                | 30,340.00                    |

2.3 In accordance with the profits tax returns filed by the Taxpayer, the assessor raised the following profits tax assessments on him:

| <u>Year of Assessment</u> | <u>Date of Assessment</u> | <u>Assessable Profits</u><br>\$ |
|---------------------------|---------------------------|---------------------------------|
|---------------------------|---------------------------|---------------------------------|

## INLAND REVENUE BOARD OF REVIEW DECISIONS

|         |              |            |        |          |
|---------|--------------|------------|--------|----------|
| 1976/77 |              | 18-10-1977 | 30,975 |          |
| 1977/78 |              | 28-11-1978 | 40,000 | (Note 1) |
| 1977/78 | (Additional) | 29-12-1978 | 3,821  |          |
| 1978/79 |              | 7-11-1979  | 35,839 |          |
| 1979/80 |              | 22-1-1981  | 35,641 |          |

Note 1: An estimated assessment raised by the assessor under section 59(3) of the Inland Revenue Ordinance before the Taxpayer submitted the return.

- 2.4 On 17 February 1983, the assessor raised an estimated additional assessment on the Taxpayer for the year of assessment 1976/77 in an amount of \$300,000 against which an objection was lodged on the grounds that the Taxpayer had had no substantial increase in net assets in recent years.
- 2.5 The Revenue commenced an investigation of the Taxpayer's tax affairs and he was interviewed on 11 May 1983, informed that the investigation was being conducted and advised of the penal provisions under the Ordinance. Thereafter, the Revenue elicited information from the Taxpayer about the firm which is recorded in a 'Note of interview' (refer paragraph 3.5 below).
- 2.6 In a further interview on 15 July 1983, at which the Taxpayer produced various bank statements or passbooks as promised at his first interview, he admitted that the accounts previously submitted did not reflect the correct profits of his business and promised to reconcile the total bank deposits with his business receipts in order to arrive at the correct profits for each year of assessment. On 19 July 1983, the assessor sent a 'Note of interview' to the Taxpayer for confirmation and/or comments (refer paragraph 3.6 below) but the Taxpayer gave no reply.
- 2.7 On 8 March 1984, the assessor raised an estimated additional assessment on the Taxpayer for the year of assessment 1977/78 in an amount of \$300,000 against which an objection was lodged on the ground that the Taxpayer had had no substantial increase in net assets in recent years.
- 2.8 In an interview with the assessors on 18 July 1984, the Taxpayer admitted that there had been a receipt of US\$16,500 on 10 April 1979 which he told the assessors was a commission from Taiwan for acting as an agent for the printing of a book in Hong Kong and this had not been included in the tax return submitted because it was not income derived from his business. At this interview, from the Note of interview (refer paragraph 3.7 below), it was agreed that the matter would be resolved based on the 'total bank deposits' method in that the difference between the total net bank deposits and returned sales should represent income from Taiwan, cash retail sales and overseas sales.

## INLAND REVENUE BOARD OF REVIEW DECISIONS

- 2.9 On 25 February 1985, the assessor raised an estimated additional assessment on the Taxpayer for the year of assessment 1978/79 in an amount of \$150,000 against which an objection was lodged by the Taxpayer on the ground that he could produce the record for that year for inspection at any time.
- 2.10 After further interviews and negotiations, during an interview with the assessors on 17 February 1986 which is recorded in a 'Note of interview', the Taxpayer finally agreed to total additional assessable profits of \$117,000 for the years of assessment 1976/77 to 1981/82 computed as tabulated below, the agreement being recorded in a written memorandum (refer paragraph 3.8 below):

| <u>Year of Assessment</u> | <u>Agreed Additional Profits</u><br>\$ |
|---------------------------|--|
| 1976/77                   | 23,000                                 |
| 1977/78                   | 10,000                                 |
| 1978/79                   | 37,000                                 |
| 1979/80                   | 22,000                                 |
| 1980/81                   | 13,000                                 |
| 1981/82                   | <u>12,000</u>                          |
|                           | <u>\$117,000</u>                       |

At this interview the Taxpayer was also reminded of the question of penalty.

- 2.11 Revised additional profits tax assessments for the years of assessment 1976/77 to 1981/82, based on the revised additional profits agreed, were issued on 21 February 1986.
- 2.12 Having reviewed all of the facts, on 7 April 1986 the acting Deputy Commissioner of Inland Revenue wrote to the Taxpayer informing the Taxpayer that he was of the opinion that the Taxpayer, without reasonable excuse, had made incorrect profits tax returns for the years of assessment 1976/77 to 1979/80 and that he intended to assess additional tax by way of penalty, under section 82A of the Inland Revenue Ordinance. He invited the Taxpayer to submit written representations which could be considered and taken into account before any assessments to additional tax were made. A letter dated 6 May 1988 was delivered by the Taxpayer to the Revenue and thereafter, on 6 June 1986, notices of assessment and demands for additional tax under section 82A of the Ordinance were raised as follows:

| <u>Year of Assessment</u> | <u>Tax Undercharged</u><br>\$ | <u>Section 82A Additional Tax</u><br>\$ |
|---------------------------|-------------------------------|---|
|---------------------------|-------------------------------|---|

## INLAND REVENUE BOARD OF REVIEW DECISIONS

|         |                 |                 |
|---------|-----------------|-----------------|
| 1976/77 | 2,559           | 3,300           |
| 1977/78 | 1,607           | 2,000           |
| 1978/79 | 6,758           | 8,600           |
| 1979/80 | <u>1,864</u>    | <u>2,400</u>    |
|         | <u>\$12,788</u> | <u>\$16,300</u> |

- 2.13 On 3 August 1986, the Taxpayer gave notice of appeal against these additional tax assessments under section 82B of the Ordinance which the Board treated as the Taxpayer's grounds of appeal.

### 3. DOCUMENTATION

In additional to a statement of facts prepared by the Revenue, the Board had before it the following documents:

- 3.1 a copy of the profits tax return of the Taxpayer for the year of assessment 1976/77 together with the Taxpayer's signed trading and profit and loss account, balance sheet and a commission and salaries schedule;
- 3.2 a copy of the profits tax return of the Taxpayer for the year of assessment 1977/78 together with the Taxpayer's signed trading and profit and loss account, balance sheet, furniture schedule, fixtures and fittings schedule and a commission and salaries schedule;
- 3.3 a copy of the profits tax return of the Taxpayer for the year of assessment 1978/79 together with the Taxpayer's signed trading and profit and loss account, balance sheet, furniture schedule and a commission and salaries schedule;
- 3.4 a copy of the profits tax return of the Taxpayer for the year of assessment 1979/80 together with the Taxpayer's signed trading and profit and loss account, balance sheet, furniture schedule and a commission and salaries schedule;
- 3.5 a copy of a 'Note of interview' with the Taxpayer dated 11 May 1983;
- 3.6 a copy of a 'Note of interview' with the Taxpayer dated 15 July 1983;
- 3.7 a copy of a 'Note of interview' with the Taxpayer dated 18 July 1984;
- 3.8 a copy of a memorandum of agreement dated 17 February 1986 signed by the Taxpayer agreeing to the total additional assessable profits of \$117,000 for the years of assessment 1976/77 to 1981/82;

## INLAND REVENUE BOARD OF REVIEW DECISIONS

- 3.9 a copy of a 'Note of interview' with the Taxpayer dated 17 February 1986;
- 3.10 copies of a notice of revised additional assessment for profits tax for the years of assessment 1976/77, 1977/78, 1978/79 and 1979/80;
- 3.11 copies of a notice of assessment and demand for additional tax under section 82A of the Ordinance dated 6 June 1986 in respect of the years of assessment 1976/77, 1977/78, 1978/79 and 1979/80;
- 3.12 a copy of the letter dated 3 August 1986 from the Taxpayer which the Board treated as the notice of appeal and the contents as the Taxpayer's grounds of appeal.

### 4. THE SUBMISSIONS

- 4.1 Taxpayer's submissions:
  - 4.1.1 Having been advised by the Board as to the matter in issue and the matters which the Taxpayer should address, the Taxpayer gave the Board a brief history of the firm including:
    - 4.1.1.1 The firm was under his management until 1974.
    - 4.1.1.2 Towards the end of 1974, as the Taxpayer had to travel to Taiwan to look after another business, his wife took over the management and, thereafter, the accounts were managed by his wife.
    - 4.1.1.3 His wife died on 16 April 1984.
    - 4.1.1.4 He had been a businessman for 24 years and had never understated profits in his returns.
    - 4.1.1.5 The problem arose because his wife did not keep proper records although this was not as a result of her intention to understate profits.
    - 4.1.1.6 The understated profits concerned commissions received from Taiwan for the printing of a book.
    - 4.1.1.7 Before his retirement, the firm had made losses.
  - 4.1.2 The Taxpayer concluded by describing his current circumstances. Having retired in 1986, he had no source of income save for rental income from Shanghai and \$750 per month provided by his nephew for living expenses.

## INLAND REVENUE BOARD OF REVIEW DECISIONS

- 4.1.3 In answers to question from the Board, the Taxpayer stated that the business of the firm was the publication of English books. The firm had always employed a bookkeeper but the Taxpayer stated that they had not done a very good job. The Taxpayer employed salesmen to obtain advertising revenue.
- 4.2 Revenue submission:
- The Revenue submission was in written form. The Taxpayer was given a copy and, as the Revenue representative read out his written submission, this was translated into Cantonese for the benefit of the Taxpayer. The Revenue submission may be summarised as follows:
- 4.2.1 The Taxpayer had made incorrect returns and understated his profits without reasonable excuse. As there had been no prosecution under section 80(2) or 82(1), the Taxpayer was liable to be assessed for additional tax under section 82 of the Ordinance.
- 4.2.2 On the specific grounds of appeal advanced to the Board:
- 4.2.2.1 The Commissioner was well aware of the Taxpayer's age, health and circumstances and the penalties had been imposed after an allowance had been made for these factors.
- 4.2.2.2 Losses in subsequent years, namely 1984/85 and 1986/87, were irrelevant.
- 4.2.2.3 Whilst the Taxpayer's stricken circumstances had been taken into account, it was the duty of the Commissioner to impose a proper and appropriate penalty and not to adjust penalties to fit individual needs. The financial difficulties of the Taxpayer had been taken into account by allowing him to discharge the tax by monthly instalments. This concession was in spite of the fact that, on the disposal of a property in 1985, the Taxpayer had taken from the proceeds of sale a sum in excess of the additional tax and penalties ultimately assessed and imposed (refer 'Note of interview' of 17 February 1986).
- 4.2.3 The representative of the Revenue also drew to the Board's attention the following:
- 4.2.3.1 The Taxpayer had been in business since 1960 and had a long history of dealing with the Revenue, so that it was logical to assume that he was aware of the statutory obligation to submit correct returns. Submission of incorrect returns had caused the Revenue to expend additional effort to quantify his exact liability to tax, and this was to be discouraged.

## INLAND REVENUE BOARD OF REVIEW DECISIONS

4.2.3.2 The penalty was only 42.5% of the maximum penalty and the Taxpayer had put forward no reasonable excuse which should be taken into account in considering his appeal.

4.3 The Taxpayer's reply:

4.3.1 The Taxpayer stated that he agreed to the content of the submission made by the Inland Revenue.

4.3.2 He reiterated that he was very weak and in bad health, and he asked for a reduction to enable him to pay the balance in a lump sum as he did not want the matter to drag on any further.

4.4 Questions from the Board:

In answer to questions from the Board, the Taxpayer stated that he was 68 years of age and the commissions from Taiwan were paid through his bank.

### 5. REASONS FOR THE DECISION

5.1 The matter under appeal

The appeal was the Taxpayer's attempt to persuade the Board that the assessments to additional tax were excessive. The Taxpayer's submissions were directed to putting the blame for the incorrect returns on his deceased wife and poor bookkeepers and on his present health and financial situation.

5.2 Matters for consideration

D58/87, IRBRD, vol 3, 11 is a relevant case in that it records the basis upon which the Commissioner assesses penalties, namely:

5.2.1 the gravity of the case;

5.2.2 the loss suffered by the Revenue;

5.2.3 the co-operation given by the taxpayer; and

5.2.4 other relevant considerations.

5.3 In D58/87, the Chairman of that Board took the following factors into account

5.3.1 the sophistication of the taxpayers;

5.3.2 the sophistication of the taxpayer's business;



## INLAND REVENUE BOARD OF REVIEW DECISIONS

5.3.3 the absence of evidence that the scheme was deliberate or designed to conceal profits;

5.3.4 the co-operation of the taxpayers.

### 5.4 Application of D58/87 to the Taxpayer

5.4.1 The Board considered whether or not the Taxpayer was a sophisticated person. It is perfectly clear that the Taxpayer's firm was in a business which required planning, establishment of business contacts and the maintaining of those business contacts to secure advertising. He had been in business for some sixteen years before the first incorrect return was made in 1977 and the Board is unable to accept that he did not know the true financial position of the firm. The Board is satisfied that the Taxpayer was aware of his obligations under the Ordinance when he signed the accounts attached to the returns for the relevant years of assessment. It is all too common for taxpayers to blame third parties, in this instance poor bookkeepers and his deceased wife. However, the Board cannot accept that the Taxpayer was so unaware of the business of his firm as to be unable to detect that the information accompanying his returns was incorrect.

The Board is satisfied the Taxpayer could not be described as an unsophisticated person.

5.4.2 The nature of the Taxpayer's business.

For the reasons already stated in paragraph 5.4.1 above, the Board is unable to categorise the firm as an unsophisticated business.

5.4.3 Absence of evidence that the scheme was deliberate or intended to conceal tax.

On the facts, income which had accrued was simply not reported for tax purposes. Particularly, in 1979 a considerable sum was not disclosed and this was not income from cash sales: it was income which came through a bank and would have been well documented. There can be absolutely no excuse for this not being included in the accounts accompanying the return.

It is the opinion of the Board that the Taxpayer was endeavouring to conceal his full liability to tax.

5.4.4 Co-operation of the Taxpayer.

The investigation had commenced in May of 1983 and it was not until February 1986, almost three years later, that the Taxpayer agreed his liability with the

## INLAND REVENUE BOARD OF REVIEW DECISIONS

Revenue. The Board would not classify the Taxpayer's contribution to this investigation as full co-operation.

### 5.4.5 Are these additional assessments excessive?

The facts disclose that the total undeclared income amounted to \$117,000, marginally in excess of 50% of the profits of \$227,445 volunteered before the investigation, and that the tax after investigation amounted to \$14,512, \$12,788 more than the tax of \$1,732 assessed on the false returns. The additional tax assessed under section 82A amounts to some 130% of the tax sought to be evaded.

Taking into consideration the period of time over which the tax was outstanding, the Board is not prepared to rule that the additional assessments are in any way excessive.

The Board is satisfied that the Taxpayer knew what he was doing before the investigation. Throughout the investigation, he did not make any real attempt to assist in the achievement of a speedy conclusion to the investigation.

The Board does not consider the comparatively small sums of money involved as relevant to the principles involved. The liability to tax existed, whether the tax was \$1,600 or so or many many times that amount. Those who successfully evade tax, and those who are successful in the short, medium or long term, expose honest taxpayers to the potential for higher taxes and do not deserve any sympathy when they are exposed. We have low taxes in Hong Kong and those who seek to evade these modest taxes do not deserve to retain the benefits, if any, thereby accruing as a consequence. Detection of evasion is not achieved without cost. Attempts at evasion must be considered with the actual or potential disadvantage to those who are honest in their dealings with the Revenue in mind.

## 6. DECISION

For the reasons given, the Board dismissed this appeal.