

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D58/87

Personal assessment – whether penalties excessive – statement of relevant criteria – s 82A of the Inland Revenue Ordinance.

Panel: William Turnbull (chairman), Raphael C Y Chan and Donald Yeung.

Date of hearing: 16 December 1987.

Date of decision: 21 January 1988.

The two taxpayers carried on a garment manufacturing business. They filed profits and salaries tax returns late, and did not keep accounting records. Their returns omitted significant amounts of income. The Commissioner's investigations took two years to complete. The Commissioner imposed penalties on the taxpayers equal to 47% and 46% respectively of the maxima permitted. The taxpayers claimed that the penalties were excessive.

Held:

The penalties were excessive. In assessing penalties, relevant factors are (among others) the gravity of the case, the loss suffered by the Revenue and the co-operation given by the taxpayer. The failure by a person who carries on a business to maintain adequate records justifies substantial penalties. However, in view of (a) the absence of any deliberate scheme or system to conceal income, (b) the taxpayer's co-operation and (c) the taxpayers' ignorance of law and lack of education, the penalties were excessive and should be reduced to 33.33% of the maximum permitted.

Appeal allowed in part.

Mr Chan Cheong Tat for the Commissioner of Inland Revenue.

Taxpayers in person.

Decision:

First we summarise the relevant facts as follows:

INLAND REVENUE BOARD OF REVIEW DECISIONS

The two appellants were de facto husband and wife but were not legally married and their relationship was not recognised by the Commissioner for taxation purposes. Though not legally married we will for the sake of convenience refer to them as 'the husband' and 'the wife' in this decision.

In 1973 the two Taxpayers established a garment manufacturing business equally owned by each of them and in 1978 the wife took over as the sole proprietress of the business.

At the hearing of the appeals both the husband and the wife appeared before this Board but the submissions were almost entirely made by the wife on behalf of herself and the husband. It would appear that for practical purposes she was the dominant person in the garment business from the date when it was first established.

The Taxpayers were late in filing Profits and Salaries Tax Returns and in September 1982 they were requested to attend for an interview at the Inland Revenue Department. In the course of that interview various questions were asked regarding the garment business and their personal tax affairs. They were asked to produce the accounting records of the garment business but failed to do so.

In default of receiving any accounting records for the garment business, the Inland Revenue Department decided to assess the taxable income of the two Taxpayers on the basis of Assets Betterment Statements ('ABS').

Following negotiations between the Taxpayers and the Inland Revenue Department the tax liability of the two Taxpayers was eventually agreed and settled. The result showed that the Profits Tax Returns filed for the garment business had significantly under-disclosed the taxable profits of the business and the Salaries Tax Returns filed by the husband likewise had substantially under-estimated his taxable income.

The dates and sums involved can be shown in tabular form as follows:

<u>The Garment Business</u>				
<u>Year of Assessment</u>	<u>Date of Return</u>	<u>Profits (Loss) per return</u>	<u>Agreed Profits as per ABS</u>	<u>Tax thereon</u>
1976/77	26-2-81	\$40,000	\$333,250	\$49,987
1977/78	26-2-81	\$60,000	\$333,251	\$49,987
1978/79	26-2-81	\$100,000	\$174,610	\$26,191
1979/80	22-8-80	(\$760)	\$219,375	\$32,906

INLAND REVENUE BOARD OF REVIEW DECISIONS

1980/81	23-6-81	(\$41,477)	\$219,375	\$32,906
1981/82	14-6-82	(\$34,821)	\$219,375	\$32,906
1981/82	15-7-82	(\$208,923)	-	-
1982/83	-	-	\$91,407	<u>\$13,711</u>
Total Tax :				<u>\$238,594</u>

Salaries Tax

<u>Year of Assessment</u>	<u>Date of Return</u>	<u>Husband's Salary per return*</u>	<u>Tax thereon</u>	<u>Agreed Salaries as per ABS</u>	<u>Tax thereon</u>
1977/78	5-8-82	\$15,000	\$143	\$57,855	\$6,963
1978/79	5-8-82	\$41,000	\$3,200	\$202,729	\$30,409
1979/80	5-8-82	\$59,500	\$6,125	\$223,563	\$33,534
1980/81	5-8-82	\$60,000	\$4,500	\$223,563	\$33,534
1981/82	5-8-82	\$72,600	<u>\$6,150</u>	\$223,563	<u>\$33,534</u>
Total tax :			<u>\$20,118</u>	Total Tax :	<u>\$137,974</u>

*The total salary declared included salaries paid to the Husband and the Wife from a limited company owned by them which was operating at a loss. As the marriage was not recognised the Husband was only assessed on his own salary. The ABS likewise only took into account the increase in wealth of the Husband and any increase in the wealth of the Wife was included in the ABS. of the Wife relating to the Garment Business.

Consequent upon the foregoing the Commissioner issued notices of his intention to consider penalty assessments under Section 82A of the Inland Revenue Ordinance. After receiving representations made on behalf of the two Taxpayers he assessed additional tax by way of penalty under section 82A as follows:

	<u>The Wife re the Garment Business</u>		<u>The Husband re Salaries Tax</u>	
<u>Y/A</u>	<u>Tax undercharged</u>	<u>Penalty Assessed</u>	<u>Tax undercharged</u>	<u>Penalty Assessed</u>

INLAND REVENUE BOARD OF REVIEW DECISIONS

1976/77	\$49,987	\$75,000	\$6,820	\$10,200
1977/78	\$49,987	\$75,000	\$27,209	\$40,800
1978/79	\$26,191	\$39,300	\$27,209	\$38,800
1979/80	\$32,906	\$46,500	\$29,034	\$38,500
1980/81	\$32,906	\$43,600	\$27,384	#34,000
1981/82	\$32,906	\$40,900	-	-
1982/83	<u>\$13,711</u>	<u>\$16,000</u>	<u>-</u>	<u>-</u>
	<u>\$238,594</u>	<u>\$336,300</u>	<u>\$117,856</u>	<u>\$162,300</u>

Speaking on behalf of the two Taxpayers the wife submitted to the Board that the garment business was only a small business and did not employ sufficient staff to maintain a proper accounting system. She explained that when the Inland Revenue Department investigated the case she had provided what information she could but was not able to answer all of the questions because she could not trace the information. She had not been able to provide accounts because none existed.

She explained that she and the Husband had been able to settle their tax liability by instalments and had paid some of the penalty assessments. She submitted that the amount of the penalty assessments was excessive taking into account all of the relevant circumstances.

The representative for the Commissioner called to give evidence the officer of the Inland Revenue Department who had investigated this case. He said that the investigations had taken some two years and because there were no records of the business he had had to compile Assets Betterment Statements.

The question for the Board to decide is whether or not on the facts of these particular appeals the penalties assessed by the Commissioner are excessive. The facts submitted by the Commissioner were not challenged and no questions of law arise.

The basis on which the Commissioner assesses penalties is to take into account all factors which include the gravity of the case, the loss suffered by the Revenue, the co-operation given by the Taxpayer and other relevant considerations. After taking into account all of these considerations the Commissioner has assessed penalties on the Wife of 141% of the tax under-charged or 47% of the maximum penalty and on the Husband 138% of the tax under-charged or 46% of the maximum penalty.

INLAND REVENUE BOARD OF REVIEW DECISIONS

With due respect to the Commissioner we consider that the penalties are excessive on the facts before us.

There can be no excuse for anyone carrying on a business in Hong Kong without adequate records to enable the filing of accurate tax returns. Likewise any person in receipt of income which is subject to Salaries Tax must keep adequate records to enable tax returns to be correctly submitted. The two Taxpayers in this case totally failed in their obligations under the Inland Revenue Ordinance and they have no one to blame but themselves. In such cases it is appropriate that substantial penalties should be imposed. The Inland Revenue Ordinance makes provision for the imposition of very heavy penalties for those who fail in their obligations under the Inland Revenue Ordinance. The maximum penalty can be as much as three times the amount of the tax underpaid or not paid and this is in addition to payment of the tax itself.

In the present case there is no evidence to show that the Taxpayers embarked upon any deliberate scheme or system to conceal their taxable income from the Commissioner. They did not set up any elaborate system to understate their income. Whilst it is true to say that the investigation by the Inland Revenue Department was difficult and lengthy, it would also appear that the appellants did not try to impede the investigation but co-operated so far as they could. The fact was they did not maintain records and were unable to produce accounts.

For failing to keep records and for ignoring their obligations under the Inland Revenue Ordinance the two Taxpayers deserve to be penalized and it is right and proper that the penalties should be substantial. However the facts of this case are no worse than others which have in the past come before the Board of Review where lesser penalties have been imposed. On the facts we consider that to impose penalties of more than 100% of the tax under-charged or 33.3% of the maximum penalty would be excessive.

In coming to our decision we have placed considerable weight on the nature of the garment business and the characters of the two Taxpayers who appeared before us. They did not appear to be sophisticated persons with high education or having any knowledge or skill in either taxation or accounts. Whilst ignorance of the law and lack of education is no excuse, it is a relevant consideration when assessing penalties. The garment business was likewise unsophisticated. It was a small factory which operated without great resources and without adequate accounting staff or records. This is not a case where the Taxpayers had maintained false records or deliberately attempted to conceal assets. Had such been the case, this would have been a criminal case and not a section 82A penalty tax case.

Having decided that the appropriate penalties in this case should be 100% of the tax undercharged or not charged we order that the assessments appealed against be reduced as follows:

Madam A

INLAND REVENUE BOARD OF REVIEW DECISIONS

<u>Year of Assessment</u>	<u>As assessed by the Commissioner</u>	<u>Reduced assessment decided by the Board</u>
1976/77	\$75,000 be reduced to	\$49,987
1977/78	\$75,000 be reduced to	\$49,987
1978/79	\$39,300 be reduced to	\$26,191
1979/80	\$46,500 be reduced to	\$32,906
1980/81	\$43,600 be reduced to	\$32,906
1981/82	\$40,900 be reduced to	\$32,906
1982/83	<u>\$16,000</u> be reduced to	<u>\$13,711</u>
	Total : <u>\$336,300</u> be reduced to	<u>\$238,594</u>

Mr. B

<u>Year of Assessment</u>	<u>As assessed by the Commissioner</u>	<u>Reduced Assessment decided by the Board</u>
1977/78	\$10,200 be reduced to	\$6,280
1978/79	\$40,800 be reduced to	\$27,209
1979/80	\$38,800 be reduced to	\$27,409
1980/81	\$38,500 be reduced to	\$29,034
1981/82	<u>\$34,000</u> be reduced to	<u>\$27,384</u>
	Total : <u>\$162,300</u> be reduced to	<u>\$117,856</u>