

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D5/94

Penalty tax – business proprietor – incorrect returns – quantum of penalties – section 82A of the Inland Revenue Ordinance.

Panel: William Turnbull (chairman), Kenneth Ku Shu Kay and Richard Lee.

Date of hearing: 28 October 1993.

Date of decision: 21 April 1994

The taxpayer was the sole proprietor of a number of businesses. He filed incorrect tax returns over a period of years. The Commissioner imposed penalties upon the taxpayer of approximately 145% of the tax which would have been underpaid. The taxpayer submitted that the penalties were excessive.

Held:

The penalties were excessive and should be reduced to an amount equal to the tax which would have been undercharged. The basis of the Commissioner imposing more severe penalties was that he considered the taxpayer to have been uncooperative, evasive and frivolous. The taxpayer appeared in person before the Board and gave evidence which satisfied the Board that the serious view taken of the case by the Commissioner was not justified.

Allowed in part.

Wu Hon Keung for the Commissioner of Inland Revenue.

Taxpayer in person.

Decision:

This is an appeal by a taxpayer against six additional tax assessments raised upon him under section 82A of the Inland Revenue Ordinance for failing to file correct profits tax returns. The facts are as follows:

1. During the years of assessment 1980/81 to 1986/87 inclusive which are the relevant years for this appeal, the Taxpayer was the sole proprietor of the following businesses:

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- a. Company A (Co A) – which commenced operation in mid-1978 and ceased business in early 1985 carrying on business as a retailer.
 - b. Company B (Co B) – which commenced operation in late 1982 but was only registered with the Business Registration Office of the Inland Revenue Department in late 1986. This business was carried on at premises which were purchased by the wife of the Taxpayer in late 1982.
 - c. Company C (Co C) – which commenced operation in early 1985 carrying on business as a retailer.
2. Apart from the above businesses the Taxpayer also had investments in various fields.
3. The profits tax returns and supporting accounts submitted by the Taxpayer for Co A and Co B for the relevant years of assessment were as follows:

<u>Business</u>	<u>Year of Assessment</u>	<u>Basis Period (year ended)</u>	<u>Date of Filing Return</u>	<u>Profits/ (Loss) Per Return</u> \$	<u>Assessed Profits/ (Loss) after Adjustment</u> \$
Co A	1980/81	31-12-1980	24-8-1981	2,601	44,600
Co A	1981/82	31-12-1981	19-8-1982	(15,718)	39,147
Co B	1982/83	31-3-1983	15-3-1988	(116,048)	(116,048)
Co B	1983/84	31-3-1984	15-3-1988	(133,521)	(133,521)
Co B	1984/85	31-3-1985	15-3-1988	44,137	44,137
Co B	1985/86	31-3-1986	16-4-1987	107,485	106,587
Co B	1986/87	31-3-1987	15-3-1988	264,502	264,502

4. On 20 January 1988 the Taxpayer attended an interview at the Inland Revenue Department when he was told that his tax affairs were being investigated. The profits tax returns for Co A were shown to the Taxpayer and he confirmed that the same were correct.
5. In the course of the investigation a number of additional tax assessments were raised on the Taxpayer in respect of Co A and Co B as follows:

Co A

Co B

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<u>Year of Assessment</u>	<u>Assessable Profits</u> \$	<u>Assessable Profits</u> \$
1979/80	<u>150,000</u> (Additional)	-
1980/81	<u>300,000</u> (Additional)	-
1981/82	<u>300,000</u> (Additional)	-
1982/83	<u>800,000</u> (Additional)	<u>800,000</u>
1983/84	<u>900,000</u> (Additional)	<u>900,000</u>
1984/85	<u>670,000</u> (Additional)	<u>670,000</u> (Additional)
1985/86	-	<u>260,000</u> (Additional)
1986/87	-	<u>120,000</u> (Additional)

The Taxpayer objected against all of these assessments and additional assessments on the ground that they were excessive.

6. The assessor collected relevant information and compiled an assets betterment statement which was issued to the Taxpayer on 19 February 1990 showing an overall profit of \$4,711,826 during the period from 1 January 1979 to 31 March 1987.

7. Following various meetings, the provision of further information, and enquiries made by the assessor the objections by the Taxpayer to the various estimated assessments and estimated additional assessments against which the Taxpayer had objected were referred to the Commissioner for his determination. The Commissioner of the Inland Revenue by his determination dated 30 December 1992 took into account the objections made by the Taxpayer as verified by the assessor. The various assessments were annulled or reduced and the following table shows the assessable profits before and after investigation and the amount of tax undercharged:

<u>Business</u>	<u>Year of Assessment</u>	<u>Profits/(Loss) before investigation</u> \$	<u>Profits after investigation</u> \$	<u>Profits understated</u> \$
Co A	1980/81	44,600	101,244	56,644
Co A	1981/82	39,147	260,600	221,453
Co B	1982/83	(116,048)	-	-
Co B	1983/84	(133,521)	396,240	396,240
Co B	1984/85	44,137	512,511	468,374

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Co B	1985/86	106,587	339,571	232,984
Co B	1985/87	<u>264,502</u>	<u>382,349</u>	<u>117,847</u>
		<u>249,404</u>	<u>1,992,515</u>	<u>1,493,542</u>

<u>Business</u>	<u>Year of Assessment</u>	<u>(Loss) over-claimed</u> \$	<u>Tax that would have been charged if the returns were accepted as correct</u> \$	<u>Tax charged after investi-gation</u> \$	<u>Tax under-charged</u> \$
Co A	1980/81	-	-	7,311	7,311
Co A	1981/82	-	-	39,090	39,090
Co B	1982/83	(116,048)	-	-	-
Co B	1983/84	(133,521)	-	68,436	68,436
Co B	1984/85	-	-	113,354	113,354
Co B	1985/86	-	62,709	102,317	39,608
Co B	1986/87	-	<u>92,167</u>	<u>112,201</u>	<u>20,034</u>
		<u>(249,569)</u>	<u>154,876</u>	<u>442,709</u>	<u>287,833</u>

8. On 13 April 1993 the Commissioner gave notice to the Taxpayer that he proposed to assess the Taxpayer to additional tax by way of penalty in respect of the incorrect profits tax returns which the Taxpayer had filed for the years of assessment 1980/81 to 1986/87.

9. By letter dated 25 May 1993 the Taxpayer made certain representations to the Commissioner.

10. On 30 June 1993 the Commissioner having considered the representations made by the Taxpayer issued the following assessments to additional tax under section 82A by way of penalty:

<u>Business</u>	<u>Year of Assessment</u>	<u>Tax Undercharged</u>	<u>Section 82A Additional Tax</u>
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		\$	\$
Co A	1980/81	7,311	10,900
Co A	1981/82	39,090	58,600
Co B	1982/83	-	-
Co B	1983/84	68,436	102,600
Co B	1984/85	113,354	169,200
Co B	1985/86	39,608	55,400
Co B	1986/87	<u>20,034</u>	<u>26,200</u>
		<u>287,833</u>	<u>422,900</u>

11. On 29 July 1993 the Taxpayer gave notice of appeal to the Board of Review against these six penalty tax additional assessments.

At the hearing of the appeal the Taxpayer duly appeared before the Board of Review in person. Having made representations he elected to give evidence and was cross examined. He maintained that he had filed true and correct tax returns and had provided the Inland Revenue Department with all of the information which it had required. He maintained that proper and correct accounts had been kept for his two businesses.

The representative for the Commissioner submitted that the Taxpayer had kept very simple accounting records in a single entry system. He said that it had not been possible to verify the accounts from the records which had been kept and there were apparent discrepancies between the reported turnovers of the businesses and the total bank deposits made in to the bank accounts of the Taxpayer. He said that for this reason the assets betterment statement procedure had been used. He pointed out that as a result of the assets betterment statement procedure and the Commissioner's determination the Taxpayer had been assessed to additional profits tax and had paid the same.

The representative for the Commissioner said that the main dispute between the Commissioner and the Taxpayer was in relation to a claim by the Taxpayer that the Taxpayer had maintained substantial sums of money in cash at his home. The representative submitted that the amount of the penalties amounted to 147% of the amount of the tax undercharged and that in the circumstances the same were not excessive.

It is now well known that the assets betterment statement procedure is not precise or exact. It is a procedure which the Commissioner is allowed to invoke when it appears to the Commissioner that the Taxpayer may not have returned his true and correct profits and the accounting records of the Taxpayer are not complete or cannot be fully verified. Such is the situation which arose in the present case.

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As can be seen from facts 1 and 2 set out above the Taxpayer is not a simple individual carrying on one business. In fact he is a businessman owning and/or concerned with a multitude of business interests. In such circumstances an individual must take care to ensure that he maintains adequate and full records of all of his various business interests. This apparently the Taxpayer failed to do. In his submission before the Board he stressed that so far as he was concerned he was of the opinion that he had kept true and correct records and had filed true and correct tax returns. Though this may have been the belief of the Taxpayer it is quite clear to this Board that in reality he had failed in his obligations under the Inland Revenue Ordinance. He did not keep adequate accounts for the two businesses which he was running namely Co A and Co B. If he had done so this case would never have arisen.

On the facts before us we are not able to find that the Taxpayer had kept proper and accurate accounts of the two businesses which he was running and we can find no reasonable excuse for his not filing correct tax returns in respect of those businesses.

That then leads us to the question of the quantum of the amount of the penalties. In this regard we have substantial sympathy for the Taxpayer. Many Boards of Review have held that where a taxpayer fails to keep proper accounts and there is no suggestion of evasion of tax the appropriate penalty should be an amount equal to the tax involved. That quantum can then be adjusted up or down to meet the particular circumstances of the case in question. From the submission made by the representative for the Commissioner it is clear that the Commissioner's point of view is that this is a bad case where the Taxpayer was not genuine in challenging the assessments to profits tax which had been raised on him during the investigation and furthermore had adopted an uncooperative attitude. In this regard we quote from the submission of the representative for the Commissioner as follows:

'The Taxpayer claimed that his accounts were absolutely accurate. Investigation revealed that the accounting records kept by the Taxpayer were simple and primitive. The Taxpayer maintained that his returns were correct. However, in view of the unreliable accounting records and having regard to the discrepancy displayed by the assets betterment statement, his returns could not be correct.

What is worse still is that the Taxpayer has all along adopted an uncooperative and evasive attitude. Apart from the note of initial interview, the Taxpayer did not confirm nor amend the note of interview taken for all subsequent interviews as requested by the assessor despite Chinese translations have been provided. The Taxpayer did not even bother to reply the proposed computation as attached in the acting chief assessor's letter dated 20 August 1992. During the initial interview held on 20 January 1988 the Taxpayer never mentioned that he had large amount of cash kept at his home. Only after the assessor had produced the assets betterment statement the Taxpayer knowing that he could not account for the discrepancy by his returned profits then introduced the frivolous claim of cash kept at home to counteract the effect of the assets betterment statement.'

With due respect to the Commissioner and his representative we do not take such a serious view of this case. We had the opportunity of hearing the submissions made

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by the Taxpayer and hearing the evidence which he gave and the answers which he gave to questions put to him in cross examination. It appears to us that the Taxpayer, even when appearing before us, had a genuine even if unfounded belief that he had maintained correct accounts for his businesses. It was obvious that he had limited accounting knowledge. It appears to the Board that probably the complexity of his business interests was substantially beyond his accounting skills and abilities. When addressing the Board and answering questions the Taxpayer was not evasive.

With regard to his alleged lack of cooperation the Taxpayer had provided to the Inland Revenue Department all of the original accounts books, receipts and records which he had maintained including statements of daily income and expenditure. If any criticism is to be raised in regard to this case then it must be that this Board is now hearing an appeal relating to penalty tax assessments in respect of years of assessment which antedate the hearing of this appeal by more than ten years. This point was raised by the Taxpayer in the course of the hearing when he said that the investigation had lasted for ten years. The representative for the Commissioner denied this and said that the Inland Revenue Department had only started its investigation in 1988. This of course begs the question. Why did the investigation start in 1988 when it related to a year of assessment, namely the year of assessment 1980/81 and why did it take some four years before the matter became final with the Commissioner's determination dated 30 December 1992. We find it hard to believe that the fault lies entirely with the Taxpayer.

Returning to the extract from the representative's submission which we have quoted above, the first paragraph would justify a penalty equal to the amount of the tax involved. The Taxpayer thought he kept proper accounts but in the event it has been shown that they were not correct. For this error or omission on the part of the Taxpayer there is no excuse. His obligations under the Inland Revenue Ordinance are quite clear. However we do not accept the second paragraph of the submission of the representative quoted above. We do not find that on the facts before us the attitude of the Taxpayer was uncooperative and evasive. There is no obligation upon a taxpayer to confirm or amend notes of interviews. With regard to the claim that the Taxpayer kept cash at home we do not find this to be a 'frivolous claim'. The Taxpayer has been unable to produce evidence to substantiate this claim but it was clear from what the Taxpayer said during the course of the hearing that he still maintains that there was a substantial sum of cash kept in his home. The Commissioner did not believe what the Taxpayer had told his assessors. Without documentary evidence to substantiate the claim of the Taxpayer, the Commissioner and his assessors were not unreasonable in rejecting the claim of the Taxpayer. However it is one thing to make a claim which cannot be substantiated and something else entirely to make a false claim with intent to deceive or defraud the Revenue. On the evidence before us we do not see the claim put forward by the Taxpayer alleging that he kept cash at home as being frivolous.

Having given the facts of this case careful consideration and having heard and seen the Taxpayer we are of the opinion that this case is no better and no worse than many of the cases which have previously come before this Board where it has been decided that a penalty equal to the amount of the tax involved is appropriate. In such circumstances it

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appears to us that the penalty imposed by the Commissioner is excessive and we direct that the total amount of the penalties imposed under section 82A of \$422,900 should be reduced to \$287,833 being an amount equal to the tax undercharged. Accordingly we direct that the six assessments against which the Taxpayer has appealed should be reduced as follows:

<u>Business</u>	<u>Year of Assessment</u>	<u>Additional Tax as assessed by Commissioner</u> \$	<u>Section 82A Amount as reduced by Board of Review</u> \$
Co A	1980/81	10,900	7,311
Co A	1981/82	58,600	39,090
Co B	1982/83	-	-
Co B	1983/84	102,600	68,436
Co B	1984/85	169,200	113,354
Co B	1985/86	55,400	39,608
Co B	1986/87	<u>26,200</u>	<u>20,034</u>
		<u>422,900</u>	<u>287,833</u>