

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D59/87

Penalty assessment – whether penalty excessive – discussion of unacceptable excuses – s 82A of the Inland Revenue Ordinance.

Panel: William Turnbull (chairman), Dr Pauline Chan and Patricia Loseby.

Date of hearing: 14 December 1987.

Date of decision: 5 February 1988.

For a number of years, the taxpayer, who carried on business as a fuel trader, did not submit profits tax returns but was content to pay estimated assessments (which were lower than his true liability). He finally objected to a high assessment and, following subsequent investigations, further assessments were issued with respect to the prior years. In addition, penalty assessments were issued equal to 33.3%, 33.3%, 33.3%, 31.8%, 19.9% and 26.6% of the maxima permitted.

The taxpayer's estate claimed that the penalties were excessive in view of (a) the taxpayer's bad health at the relevant times, (b) his reliance on an unqualified tax representative to prepare his returns, (c) the 'Chinese style' method which he used to maintain his books of account and (d) the fact that the burden of the penalty would fall on the beneficiaries of the taxpayer's estate.

Held:

The penalties were not excessive. In fact, the last three penalties might be too low. The taxpayer's excuses were unacceptable because:

- (a) The taxpayer's health did not affect his ability to carry on a successful business, and it was therefore implausible that it should affect his ability to comply with his obligations under the Inland Revenue Ordinance.
- (b) It is too common for taxpayers to blame third parties, such as bookkeepers or tax representatives, for errors in profits tax returns. It is the taxpayer himself who signs the returns and accounts, and who therefore must bear responsibility.
- (c) The accounts were quite thorough and detailed and readily comprehensible.

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- (d) The penalty assessments cannot be affected by the taxpayer's subsequent death.

Appeal dismissed.

Mr Tung Kar Che for the Commissioner of Inland Revenue.

Mr Samuel Chiu of Deloitte, Haskins and Sells for the taxpayer.

### Decision:

This is an Appeal brought against a number of Additional Tax Assessments issued under section 82A of the Inland Revenue Ordinance. It is appropriate to summarize the facts so far as they are relevant.

The Appellant was a businessman carrying on business as a fuel oil agent or trader. He had carried on this business since 1975. In respect of each of the years of assessment from 1977/78 up to and including 1982/83 the Inland Revenue Department issued routine Profits Tax Returns. The first such return was issued on 1 April 1978 and each subsequent return was issued on the 1st of April in each succeeding year except for the last year when the return was issued on 6 April 1983.

The Taxpayer did not submit any of these returns to the Inland Revenue Department and in default of receiving returns the Inland Revenue Department issued estimated assessments as follows:

<u>Year of Assessment</u>	<u>Assessable Profits</u>	<u>Date of Issue of Assessment</u>
1977/78	\$50,000	19.9.78
1978/79	\$80,000	15.10.79
1979/80	\$140,000	8.9.80
1980/81	\$250,000	30.11.81
1981/82	\$1,500,000	17.1.83

The Taxpayer did not challenge any of these estimated assessments. Following the issue of the assessment based on estimated assessable profits of HK\$1,500,000 for the year of assessment 1981/82 the Taxpayer on 18 August 1983 submitted a Profits Tax Return for the year of assessment 1982/83 in which he showed assessable profits of HK\$910,716. This return was supported with accounts for the lunar year ended 12 February 1983. The return was prepared by a firm of certified public accountants and signed by the Taxpayer.

Following the submission of this Tax Return the Appellant was interviewed by the Investigation Unit of the Inland Revenue Department on 14 February 1984. The note of

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that interview which was prepared by the Inland Revenue Department was produced before the Board of Review and indicates that the Taxpayer at that time had a very detailed knowledge of the business which he was running.

The accounts of the Taxpayer were maintained in Chinese and were produced before the Board of Review. The accounts had been submitted to the Inland Revenue Department and had been analysed by the Department. Following this analysis a proposal was made to the Taxpayer and eventually the Profits Tax liability of the Taxpayer was settled between the Taxpayer and the Inland Revenue Department for the years of the assessment 1977/78 up to and including 1982/83 as follows:

<u>Year of Assessment</u>	<u>Assessable Profits/ Additional Assessable Profits</u>
1978/79	\$391,794
1979/80	539,744
1980/81	1,661,634
1982/83	2,946,217

Additional Profits Tax Assessments and the Assessment for 1982/83 in respect of the foregoing amounts were all issued on 14 August 1984. With regard to the year of assessment 1977/78 the appellant agreed to a proposal of the Inland Revenue Department and it was agreed that the additional assessable profits were HK\$347,614. With regard to the year of assessment 1981/82 it would appear that the original estimated assessment made by the Inland Revenue Department at the figure of \$1,500,000 was not disputed by the Taxpayer and was likewise not further challenged by the Commissioner. Accordingly that assessment was allowed to stand.

After the Profits Tax had been agreed the Commissioner gave notice to the Taxpayer of his intention to consider issuing penalty additional assessments under section 82A on the ground that the Taxpayer had without reasonable excuse failed to file Profits Tax Returns for the years of assessment 1977/78 to 1981/82 and had made an incorrect return for the year of assessment 1982/83.

The certified public accountants who had been employed by the Taxpayer made representations to the Commissioner as follows:

1. The Company failed to comply with the requirements under Section 51(1) of the Inland Revenue Ordinance because the sole proprietor was in bad health during the recent years and had spent a lot of time in the hospital. Unfortunately, he is now in a very serious condition.
2. The Company's tax representative for the year of assessment 1982/83 was not a well-qualified person. As the sole proprietor was always sick and had

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no accounting knowledge, he had no idea at all of how much he had earned for the year and wholly relied on that person to file the Profits Tax Return.

3. The Company's accounting records were kept in the old Chinese Style under a single-entry system. As the company uses the Chinese New Year as its year-end-day, the balance sheet date varies every year. However, the accountant added up the purchases for the twelve months to arrive at the amount of the total purchases for the year. And by doing so he wrongly included in the amount of total purchases the transactions for those days in the month on which the Chinese New Year fell. This caused the amount of purchases being overstated.

4. The sole proprietor had no intention to evade tax. The incorrect returns were caused by mistake due to inadvertence.

Following these submissions the Commissioner on 29 December 1984 issued penalty Tax Assessments under section 82A in the following amounts:

<u>Year of Assessment</u>	<u>Section 82A Additional Tax</u>
1977/78	\$59,600
1978/79	70,700
1979/80	101,900
1980/81	273,700
1981/82	134,500
1982/83	218,400

Notice of appeal against these six penalty assessments was duly lodged by the Taxpayer through his certified public accountants. Subsequent thereto on 12 December 1985 the Taxpayer died.

At the hearing of the appeal Mr Samuel Chiu of Messrs. Deloitte Haskins & Sells appeared on behalf of the Estate of the Taxpayer. This firm of certified public accountants was not the firm previously used by the Taxpayer and had apparently been instructed to handle this appeal by the personal representative of the Taxpayer in place of the previous certified public accountants.

No witnesses were called to give evidence before us. In addition to the Chinese accounting records of the Taxpayer, Mr Chiu on behalf of the Estate of the Taxpayer produced before us a medical certificate by a qualified medical practitioner who stated that the Taxpayer had been his patient since 1979 until his death. The medical certificate expressed in general terms that the Taxpayer had suffered from anxiety depression since 1979 and that his health had deteriorated until he developed lung cancer in 1984 and died in 1985. The medical practitioner who gave the medical certificate was not called to give

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evidence or to be cross-examined. The medical certificate was undated but was presumably of recent origin and was definitely subsequent to the date of death of the Taxpayer which was 12 November 1985.

The representative for the Commissioner drew our attention to the fact that when the Taxpayer had attended at the Inland Revenue Department Offices on 14 February 1984 he had not given the impression of being a person who was very sick and had been able to answer questions put to him in considerable detail. The Commissioner's representative also drew our attention to the detailed accounts maintained for the Taxpayer's business and the comparatively simple nature of his business which comprised purchasing fuel oil from one main supplier and selling the same at a profit to a number of customers. Our attention was further drawn to the fact that it was from the books of accounts which were kept by the Taxpayer and which had been delivered to the Inland Revenue Department following the first meeting in February, 1984 that the staff of the Inland Revenue Department had calculated the true profits of the Taxpayer.

Mr Chiu on behalf of the Taxpayer submitted that with regard to the years of assessment 1977/78 to 1981/82 the additional tax was excessive and that with regard to the year of assessment 1982/83 the Taxpayer had a reasonable excuse for filing an incorrect return and that the Additional Tax was excessive. As a number of matters of principle arise we will deal with the submission of Mr. Chiu seriatim.

Mr Chiu submitted that the Taxpayer was of low educational standard and had been in a poor state of health since 1979. It has been said in the past and we repeat in this case that a lack of knowledge of the law or of accounting matters is no excuse for failing to file Tax Returns or filing incorrect Tax Returns. The Inland Revenue Ordinance places an obligation upon each person who carries on business to file correct Tax Returns. The taxation system in Hong Kong is simple and a cornerstone of the system is that taxpayers must file correct Tax Returns disclosing their full income liable to Profits Tax. Likewise the ill health of the Taxpayer has little relevance. In this particular case the evidence before us shows that the Taxpayer was able to run and operate a successful business making substantial profits. He was able to buy his stock in trade and sell it to customers. He was able to make deliveries of goods and collect payment from his customers and made payment to his suppliers. He was able to do everything which an ordinary successful businessman can do and had adequate accounts for his own purposes in running his business. However we are asked to accept that when it came to matters of taxation he suddenly was not able to handle his affairs properly, could totally ignore making Tax Returns and could file an incorrect Tax Return. With due respect to Mr Chiu such submissions can carry no weight.

Mr Chiu said that the books of accounts of the business of the Taxpayer were kept by an old employee in the old Chinese Style which was not easily understood by people of the present time. Here again we must take issue with the accuracy of the submission. The books of account were produced before us and appeared to be thorough and detailed. The Inland Revenue Department were able to understand them and were able to ascertain the taxable profits of the business which the Taxpayer operated.

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Mr Chiu then submitted that the Taxpayer had believed that when he received the estimated Tax Assessments, it was not necessary for him to file Tax Returns and because of his low education and lack of knowledge of taxation he just paid the tax demanded without realizing that he had committed offences under the Inland Revenue Ordinance. On the facts before us it is hard to substantiate this submission. The estimated assessments which the Taxpayer paid without challenge were very substantially below the actual profits made by the Taxpayer until the last one for 1981/82. It had been very much in the interests of the Taxpayer to accept the estimated assessments without query and believe that they were final.

Another submission made before us was that the Additional Tax should be reduced because the Taxpayer is now deceased and the Additional Tax will fall on the beneficiaries of the Estate. Such a submission is wholly specious. The section 82A Additional Tax Assessments were issued well before the death of the Taxpayer and, subject to this appeal, were liabilities of the Estate of the Taxpayer. Such liabilities cannot in any way be affected by subsequent events.

Mr Chiu submitted that the basis of the tax under charged had been wrongly calculated by the Commissioner. Here again we can find no substance in the submission made before us. In all of the years of Assessment in question save and except for the year 1982/83 the Taxpayer failed to file Tax Returns. Accordingly if the Commissioner had not issued estimated assessments the Taxpayer would have paid no tax whatsoever. Accordingly the tax under paid was 100% of the Taxpayer's liability, nothing more and nothing less. In support of his submission Mr Chiu referred us to section 80 of the Inland Revenue Ordinance and submitted that section 82A of the Ordinance should not apply to a case such as this one. Again with due respect we can find no substance in this submission. The Ordinance clearly states that section 82A applies where a person fails to comply with the requirements of section 51(1) which sub-section refers to the filing of routine Profits Tax Returns issued by the Commissioner.

With regard to the 82A assessment in respect of the year 1982/83 Mr Chiu submitted that the Taxpayer had a reasonable excuse in that he kept a complete set of accounting books and records in which he recorded his business transactions completely and correctly. These books and records were produced to his then certified public accountant for the preparation of his Profits Tax Return. When he signed the Profits Tax Return prepared by his certified public accountant in August, 1983 he had no reason to doubt that it was true and correct. Again Mr Chiu asked us to take into account the poor state of health of the Taxpayer at the time. Mr Chiu did not call any evidence to substantiate this part of his submission. In particular he did not call the former certified public accountants to give evidence. Here again we can find no substance in Mr Chiu's submission. It is no excuse to say that agents have been employed and that the principal is not responsible for the acts of the agents. It is an all too common occurrence in section 82A cases for taxpayers and their representatives to try to transfer the responsibility for filing Tax Returns from the taxpayer to some third party, usually the book-keeper employed by the taxpayer or the previous

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certified public accountants or tax representative. However it is not the tax representative who signs the accounts and the Tax Return Form. It is the Taxpayer himself and he signs the form in a section of the Tax Return headed 'declaration' and makes a specific declaration that the Return is correct. Furthermore there is printed in English and Chinese immediately under the signature of the taxpayer a statement that heavy penalties may be incurred if an incorrect Return is made.

Throughout the years in question the Taxpayer totally disregarded his obligations under the Inland Revenue Ordinance. He was happy to pay tax, when assessed, at sums substantially below his true liability. In the last of the years in question, knowing that his affairs were being investigated, he signed a Tax Return which under stated his profit. For these acts and omissions he is and should be accountable under section 82A of the Inland Revenue Ordinance.

On the facts before us we do not consider that the amounts of the section 82A Additional Assessments are excessive. The Legislature has decided that the Inland Revenue of Hong Kong must be fully protected. To do so, provision has been included in the Inland Revenue Ordinance that penalties of up to three times the amount of the tax involved can be imposed where there is a breach of the provisions of the Ordinance. In this case the Commissioner has issued penalty assessments under section 82A as follows:

<u>Year of Assessment</u>	<u>Penalty Assessed</u> \$	<u>Maximum Penalty</u> \$	<u>Approx. %</u>
1977/78	59,600	178,926	33.3%
1978/79	70,700	212,307	33.3%
1979/80	101,900	305,883	33.3%
1980/81	273,700	860,238	31.8%
1981/82	134,500	675,000	19.9%
1982/83	<u>218,400</u>	<u>821,325</u>	26.6%
	<u>858,800</u>	<u>3,053,679</u>	

Bearing in mind that the maximum penalty is three times the amount of Tax under-assessed or not assessed a penalty of approximately 1/3 of the maximum translates into an amount equal to the tax under-charged or not charged. Looking at it from another point of view, the Taxpayer is required to pay Profits Tax and penalties of approximately twice the amount which he would have had to pay had he filed true and correct Tax Returns in the first instance. This is not unreasonable. Indeed it could be said that the penalty

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assessments for the three years 1980/81, 1981/82 and 1982/83 are too low. However as the Commissioner at the hearing has not sought to increase the amounts it would be inappropriate for this Board to do so.

For the reasons given we dismiss this appeal and confirm all of the assessments appealed against.